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.

Recession Fears – Yeah, Nah

One day we will have another recession in New Zealand – as will every other economy at some stage. Over the past four decades we have all become used to the severity of those recessions being mitigated by central banks rapidly cutting interest rates. The lower rates quickly reduce business borrowing costs and that means the pressure to slash costs by laying people off is reduced. Lower interest rates also ease mortgage servicing burdens for home owners and reduce the number of forced house sales and curtail expectations of house price falls. Lower interest rates also reduce pressure to sell shares.

Fears abound now that because inflation around the world is structurally lower than before, and because interest rates are so low despite good growth rates, scope to cut rates and help economies when the next recession comes will be limited. True. Future downturns risk being worse than those on average of the past.

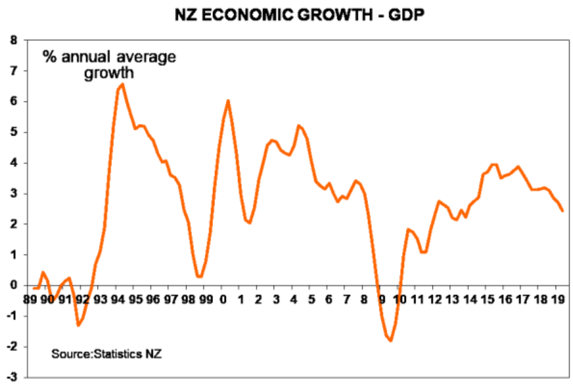
The problem here is that this message is not yet being delivered in sufficient strength by central banks. There has certainly been some discussion of the need for governments to consider fiscal policy measures (cutting tax rates, boosting spending) when downturns next hit. But there are two huge problems here.

First, central bankers have yet to stand in front of the group and admit their weakness – namely that their days as economic gods are over. Without delivering that honesty businesses, investors, and home buyers will continue to run things as they have in the past under the assumption that there will be great assistance when the next downturn comes. There won't be and people need to adjust their debt levels and build greater flexibility into their cost structures to reflect that.

No-one likes fronting the crowd and admitting their failures – and as we saw with the All Blacks coach, this reluctance to admit weakness can manifest itself as a threat of violence. It is not highly probable that either central banks or governments will anytime soon admit that their ability to fight the next downturn will be less than in the past. But they need to in order that people realise this and alter what they – you and I – do.

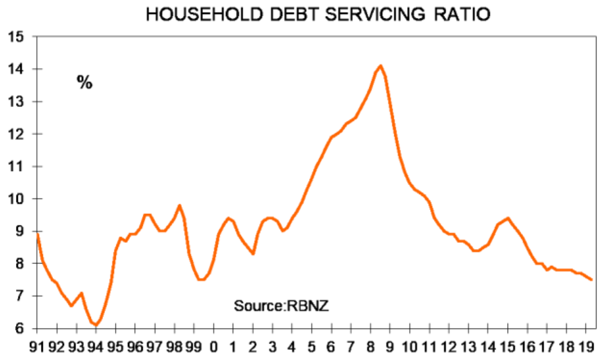
The second big problem is something pointed out here previously. Fiscal policy is not that effective at fighting downturns. The time lags involved mean that by the time measures start hitting their straps, recovery might already be underway – though from a lower turning point.

So, should you all be trembling in your shoes now? Not really. There is a big upside to sustained low inflation beyond low average borrowing costs. There has been a high tendency in New Zealand for our recessions to be associated with eye-watering interest rates. The following graph shows that we had recessions or big dips in our pace of economic growth in 1997/98, 2001, and 2008/09.



Between 1994 and 1997 the average mortgage rate rose from 8.6% to 11.6% and the household debt servicing ratio (interest as a proportion of income) went from 6.2% to 9.4%.

Between 1999 and 2000 the average mortgage rate went from 8% to 9.1% and the debt servicing ratio from 7.5% to 9.4%.



Between 2003 and 2008 the average mortgage rate went from 7.7% to 9.4% and the debt servicing ratio from 9% to 14.1%.

Each of our most recent three downturns have been preceded by hikes in borrowing costs. They then each got exacerbated by downturns offshore – the Asian Crisis, US recession, then GFC.

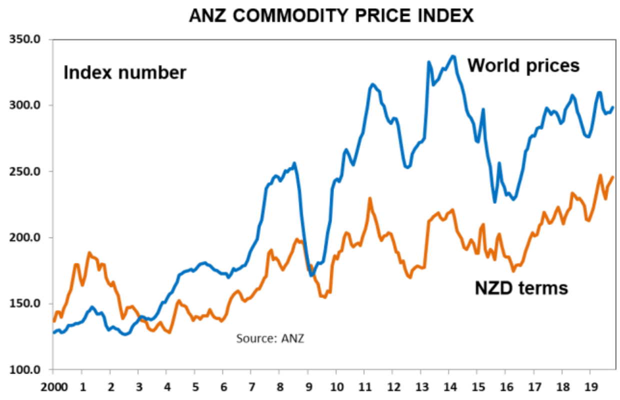
Moving up to date now we see that the average NZ mortgage rate has fallen from 6.5% in 2015 to 4.9% now and is still falling. The debt servicing ratio has fallen from 9.4% to 7.5%.

You can't make the case that we are headed for a period of economic weakness based on the traditional cause of debt servicing hikes.

That does not remove our vulnerability should weakness strike offshore for some reason. But it does mean that one of the big factors which can cause a rapid slowing in growth – consumers and businesses reacting quickly to high borrowing costs once they lose faith in sustained employment, asset price rises, and profit growth – will likely not be in play.

So, I'm not overly worried that if world growth slumps we will see a huge downturn here. For that scenario we would first need a surge in inflation which pushes borrowing costs up much higher – and as yet I can see nothing likely to come along and cause that.

Regarding world growth – the forecasts are commonly for slight recovery next year, and our export commodity prices keep rising. The ANZ Commodity Price Index in world price terms rose by 1.2% in October to lie 7.2% ahead of a year ago. You can't run a scenario of our economy taking a hit from offshore unless you forecast a financial crash of some sort. History tells us this is basically impossible to do.



Ah, I hear you say, what about those people who have gained fame from correctly predicting the GFC, or the Asian Crisis, or the 1987 crash? Thing is, there is always someone predicting a crash in the next few months or year. (Google "coming crash" or similar. Then ignore everything that pops up. There was a game many years ago where people Googled two words to see if only one result came up. It was the early days of search engines and the unitary and binary results did not last long.)

Its just luck of the draw who gets it "right".

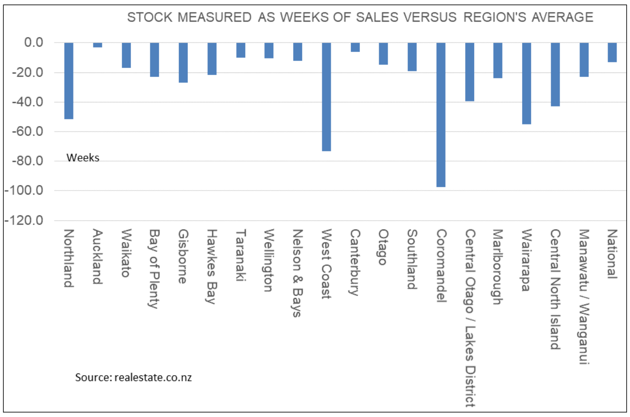
Housing Market

Last Thursday the people at realestate.co.nz released their monthly data showing how many properties are listed for sale all around the country and asking prices. I only use REINZ House Price Index price data to gauge what is happening with NZ house prices so will concentrate on just the listings data here.

When doing an exercise like this I'm looking to see if there are any big changes underway, or if things are in such a low or high state that a developing view regarding where the market might be going could be demonstrably wrong.

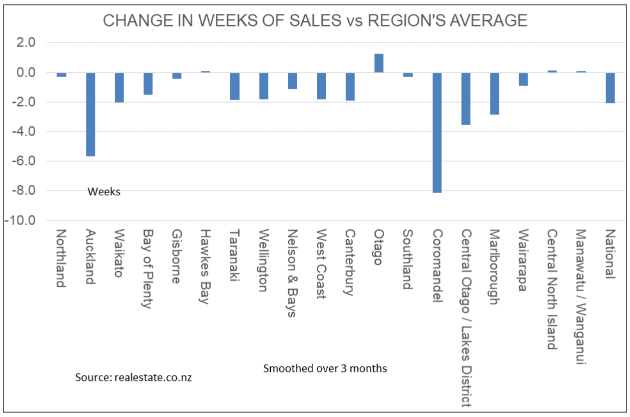
The common view right now is that price strength in the regions will continue for some time longer, and that Auckland is turning up anew. Is there anything in the listings data to challenge or reinforce that view?

This first graph shows stocks at the end of October measured in terms of weeks of sales and whether those stocks are below or above average. Looking at Northland the graph tells us that the level of stocks is 52 weeks below average. In fact, everywhere around New Zealand stocks are below average, even slightly in Auckland. If you are looking for a property you will be having greater than average difficulties in all regions.

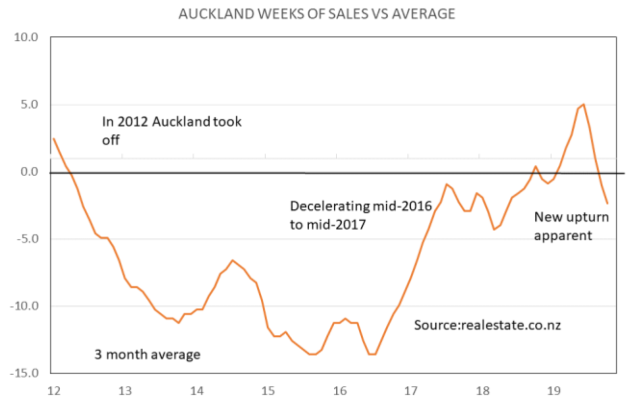


This graph and the next one are reprinted in large format at the end of Tony's View.

But in which direction are things moving? Are stocks becoming less or more tight? I attempt to examine that by comparing the latest three-month average of the above measure with three months ago. We get this graph.

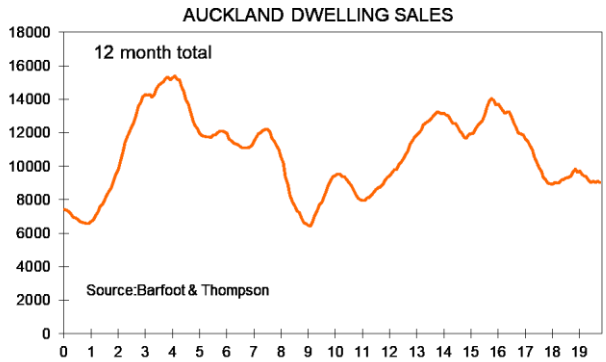


Stocks are getting tighter everywhere except Otago and maybe around the middle of the North Island. The data support the view that things are picking up, especially in Auckland. When the REINZ sales data come out in a fortnight they are likely to show strong Auckland sales.



Barfoots Data

Data from large Auckland real estate firm Barfoot and Thompsons this week revealed that during October they sold 824 dwellings. That was a fall of 7% from a year ago and for the three months to October sales were down 2.5% from a year back. But in seasonally adjusted terms the slow upward movement in sales underway from a low base around February has continued, with a small gain of 1.5% from the three months to July. Sales are slowly rising. Are prices?



Hah – trick question, as I have stated repeatedly that the only price measures I pay any attention to are the REINZ House Price Indexes. But, for the record, the Barfoots price measure has been flat in the past three months and is flat on a year ago.

Their stock of listings is down 22% from a year ago, as was the number of new listings received during the month. Talk of Auckland picking up is nowhere yet strong enough to encourage vendors into the market.

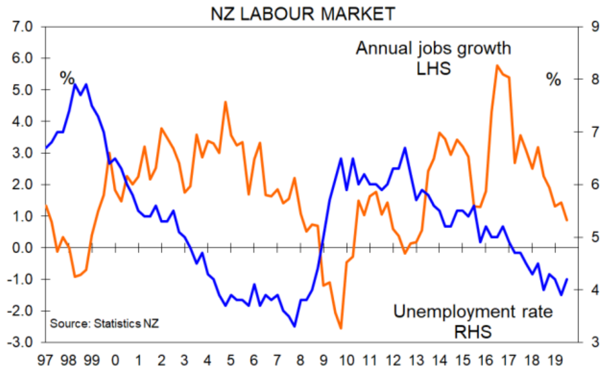
During the week an emailer offered the following opinion…

"LVR's don't matter to property investors anymore – it is completely a serviceability game now and the banks have initiated their own DTI's that make getting 3 plus houses near impossible (Investors with positive cash flow and 50% LVR over 10+ houses can't get a cent whereas 4 years ago they could have got 2m to spend)"

Interest Rates

Even though it tends to be a lagging indicator, we often look at labour market statistics to get a feel for inflationary pressures coming from the labour market, and whether consumers might spend more or less in the near future. What we learnt on Wednesday is that job numbers in New Zealand only grew by 0.2% in the September quarter after rising 0.6% in the June quarter. The change from a year ago was 0.9% and this is the slowest jobs growth rate since 2013.

Businesses are not hiring people like they were before and that means one has to be cautious with regard to expectations for retail spending growth in the near future. It also means one should be careful not to get too excited about strength in the housing market. If jobs growth is slow then this tends to restrain new bidding for houses at the auctions.

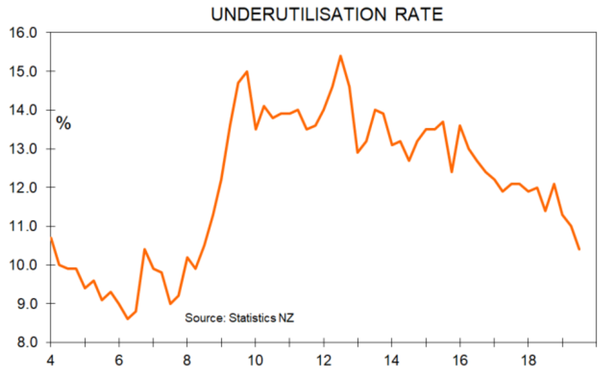


Be careful not to read too much into the lowly 0.2% jobs growth for the September quarter. These numbers can be quite volatile and if we add the last two quarters together growth was 0.8% or 1.6% annualised which is actually better than at the turn of the year.

The unemployment rate rose to 4.2% from 3.9% and with net migration inflows remaining strong a rise to 4.5% come the middle of next year looks fairly likely.

But does any of this mean that employers who are actually looking for staff are going to find themselves about to once again pick and choose amongst applicants? No. The NZIER's Quarterly Survey of Business Opinion tells us that whereas on average a net 30% of businesses have said that skilled labour is hard to find, the latest reading is a net 42% saying things are hard. And worse for many, whereas a net 8% usually say unskilled people are in short supply, now a net 28% do.

Moreover, reflecting the development of the gig economy (I'm in it, it's great, much less stress), concentrating on the unemployment rate as a measure of labour market tightness is less relevant than in the past. An increasingly preferred measure is the underutilisation rate which adds in part-timers wanting to work longer hours, people wanting work but not actively seeking, and those seeking but not available to shift yet. (Not me.)

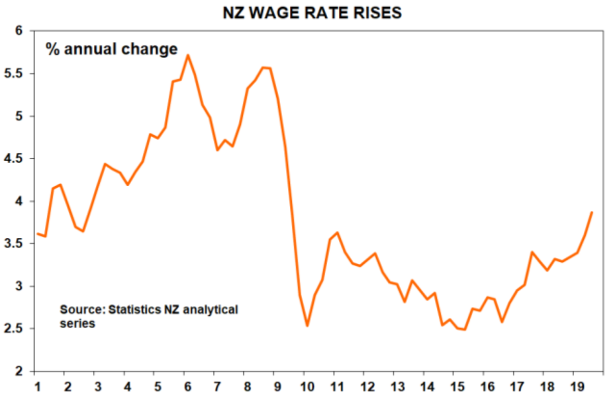


This measure fell to 10.4% in the September quarter from 11% in the June quarter and 11.4% a year ago.

So, I continue to feel that I am on safe ground saying that the labour market is tight and businesses will continue to experience problems getting staff. In fact, just last night I chatted with a neighbour trying to hire an overseas health and safety expert and a ceiling specialist. One could not be afforded because of the new minimum wage which now needs to be paid. The other was simply turned down by Immigration NZ.

Employers need to factor the structural tightening of the labour market into their plans and consider how they will cut output to reflect the labour constraint and the increasing rate at which jobs need to redone because of the low quality of some new people. Or boost labour productivity through mechanisation in some regard – robots etc.

With regard to wages growth, things continue to pick up, sort of. The measure I use comes from the Labour Cost Index calculations and tries to track wage changes for an unchanging range of positions. This measure lifted to an annual rate of growth of 3.9% from 3.6% a quarter back and a low of 2.6% in 2016.



First, the rate of increase in this measure is quite slow. Second, this measure was rising close to or above 5% from 2005 into 2009. Third, the measure which excludes the public sector, while rising 3.8% in the past year, was boosted by minimum wages going up. If we were to strip that effect out the rise would be closer to 3.3%.

Wages growth is accelerating, but it is not likely to be at a pace which will dissuade the Reserve Bank from cutting the cash rate again, probably next week.

CHOOSING YOUR FIXED MORTGAGE RATE TERM

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, especially as increasing bank preference to lend outside the farming, property development, and business sectors has encouraged the return of mortgage cashbacks.

Current minimum fixed rates across the main banks. *

1 year	3.55%
2 years	3.45%
3 years	3.89%
4 years	3.99%
5 years	3.99%

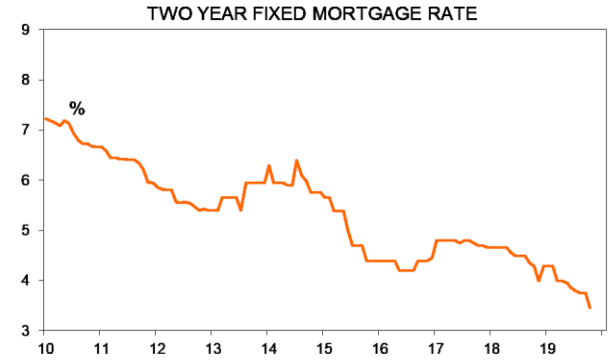
TSB cut some rates to match other banks this week but no new minimums were set so no new analysis is presented here compared with last week.

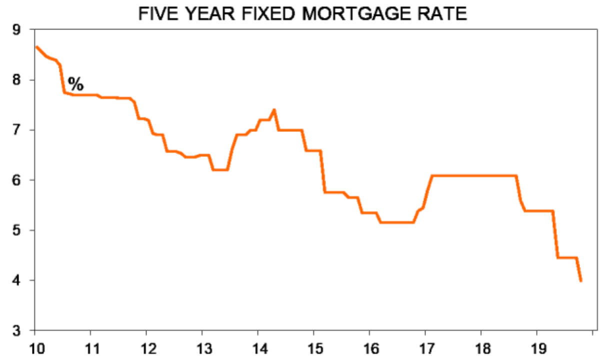
I can fix 2 years at 3.45%.

Is this better than fixing 1 year?	Yes, if in 1 year the 1-year rate is higher than 3.35%.
Is this better than fixing 3 years?	Yes, if in 2 years the 1-year rate is below 4.77%.
Is this better than fixing 4 years?	Yes, if in 2 years the 2-year rate is below 4.53%
Is this better than fixing 5 years?	Yes, if in 2 years the 3-year rate is below 4.35%.

The odds for now favour 1+1 being cheaper given the global and local monetary policy easing cycles underway. But not by much. I'd be happy with 3.45% for 2 years. But should central bankers talk more strongly about further interest rate cuts being pointless, I'd start eyeing up a longer term.

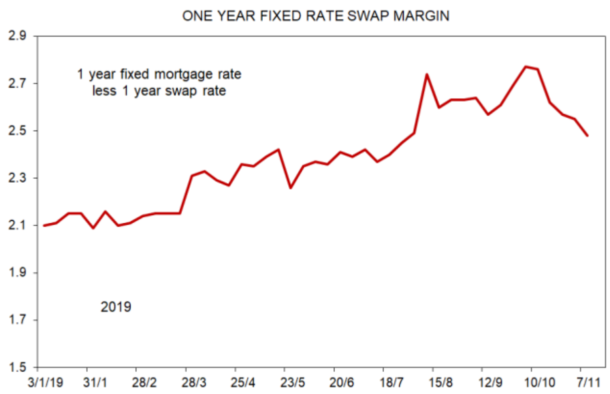
*Minimum 20% deposit, owner occupiers.
Compounding is minor so is ignored.

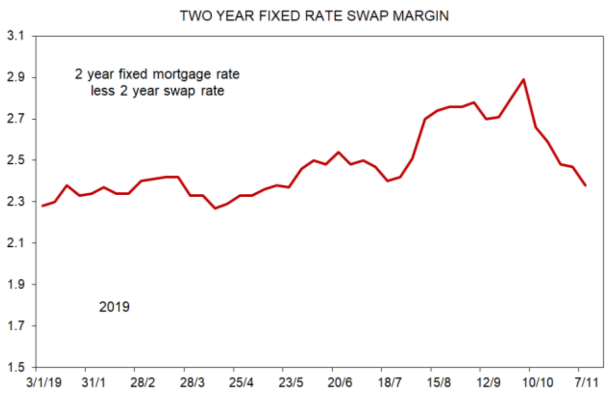


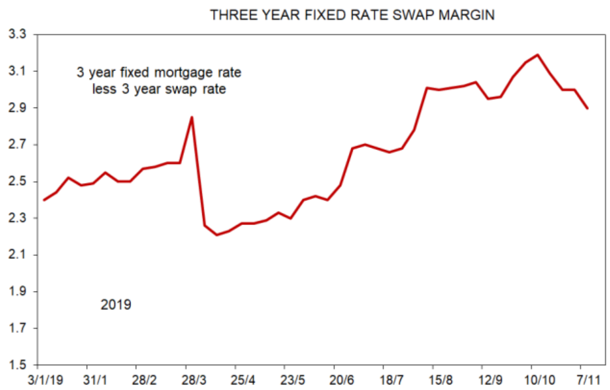


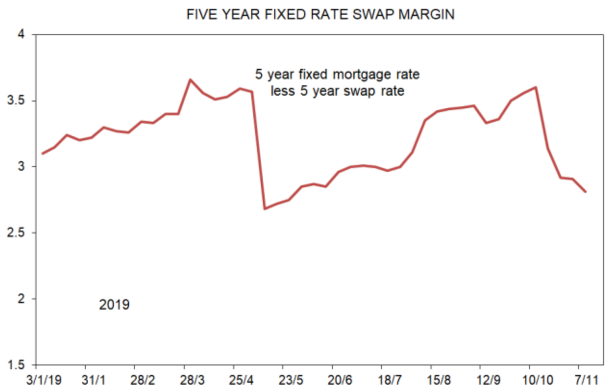
IS A FIXED RATE CHANGE IMMINENT?

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. Banks have boosted their margins over the year, and the 3-year rate looks somewhat high.









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.

Tony's View

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).

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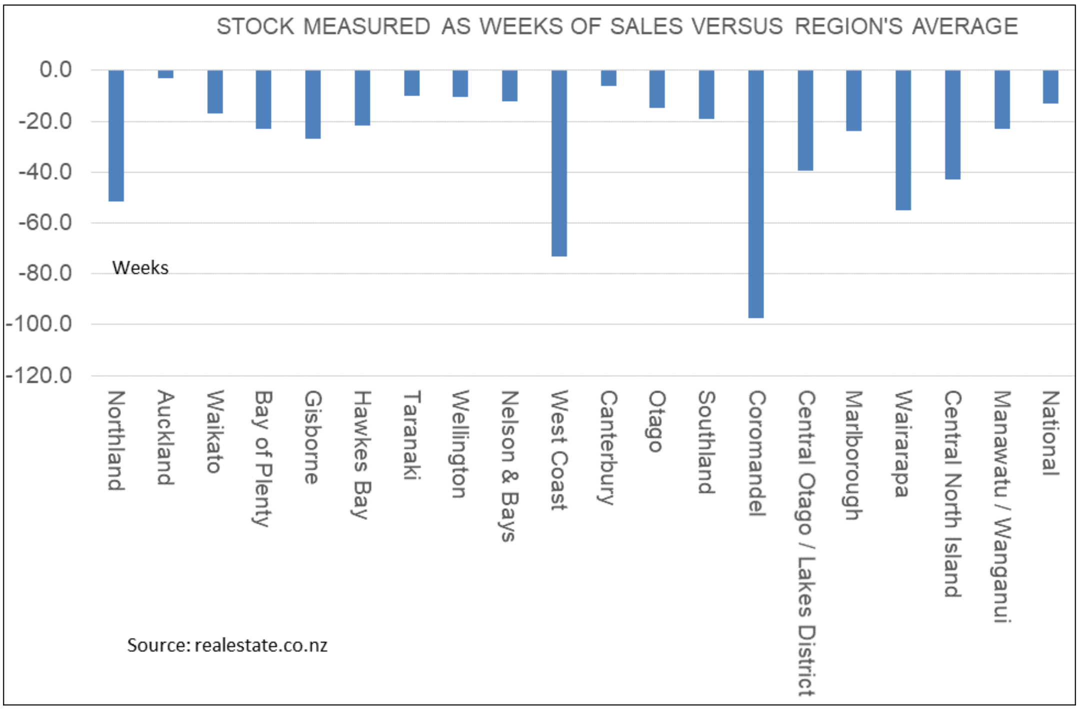
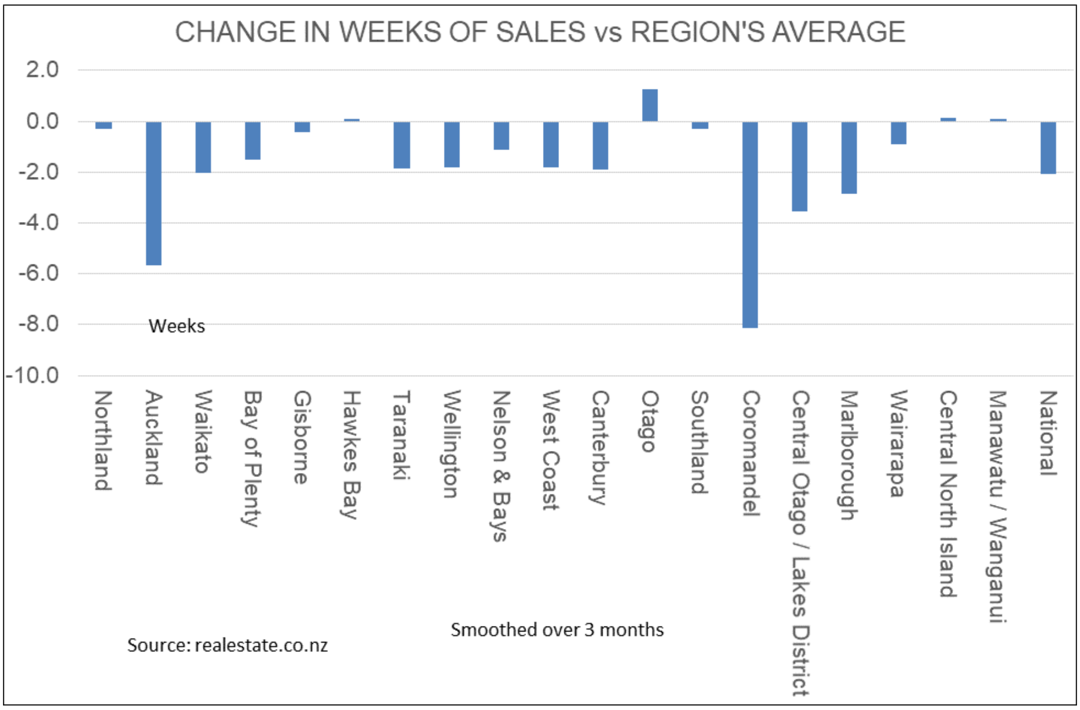
This publication is written by Tony Alexander, independent economist. You can contact me via LinkedIn or email tonyalexander5@outlook.com

DETAILED GRAPHS ENLARGED




CHANGE IN WEEKS OF SALES vs REGION'S AVERAGE
2.0
0.0
-2.0
-4.0
-6.0
-8.0
-10.0
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
Smoothed over 3 months