TONY'S VIEW

Input to your Strategy for Adapting to Challenges
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ISSN: 2703-2825
Thursday 8 October 2020
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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.

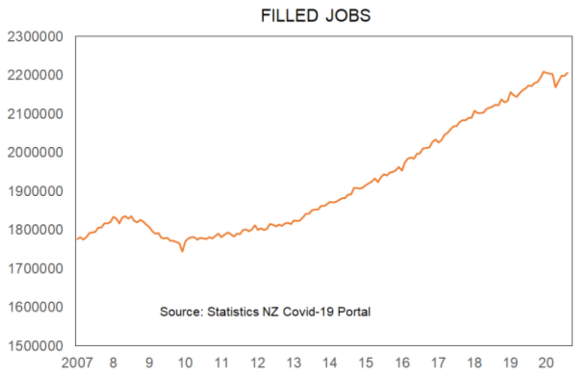
The Upside

This week I thought it would be a good idea to take a run-through some of the economic indicators which are turning upward or at least surprising on the good side, starting with the labour market.

Labour Market

Early in this crisis a number of people predicted collapsing employment and the unemployment rate rising to 20%. Things have thankfully turned out a lot better than expected so far, and further employment surprises are possible.

The number of Filled Jobs measured by Statistics NZ on the basis of data from IRD was 300 higher in August than in February. Extrapolating out for what has happened between February and August on average over the past few years we can say that perhaps job numbers are about 30,000 less than would otherwise be the case. The following graph shows rising job numbers since 2007 and how this recent shock compares favourably with the period after the 2008 recession and the GFC.



Filled job numbers initially fell by 37,000 over March and April but have risen just over 37,000 since then.

This is a surprisingly good result and one perhaps to treat with caution because we have yet to see the full effect of wage subsidies ending. However, last month, in a special question seeking insight into what bothers firms most, lack of skilled staff ranked highest – just as it had before the Covid-19 crisis.

There is another up to date labour market measure we can refer to – the number of people claiming the dole (Jobseeker benefit). There has been a sizeable increase of 58,000 between March and September to produce a total of 203,000. Back in March and earlier when the unemployment rate was about 4.2%, the Jobseeker total equated to some 4.8% of the working age population (including Health Condition and Disability support). Now that proportion is 6.7%.

On that basis one might take a stab at saying that the unemployment rate currently sits near 6% - 6.5%. The GFC peak was 6.7% in 2012 so the chances are high that the unemployment rate will still be above average out toward 2023. But we have a highly flexible labour market in New Zealand, and this has capped the rise in our unemployment rate in the past and looks like it is going to do so again.

A casual look through foreign newspapers reveals far greater rigidity and disputes in other countries' labour markets. This limits willingness to make adjustments when circumstances change, throwing those adjustments directly onto staff numbers rather than changes in hours and remuneration.

Note also that here in New Zealand there is plenty of anecdotal evidence of shortages of both skilled and unskilled staff across numerous sectors – to which the government is responding by easing up on visa rules and border controls.

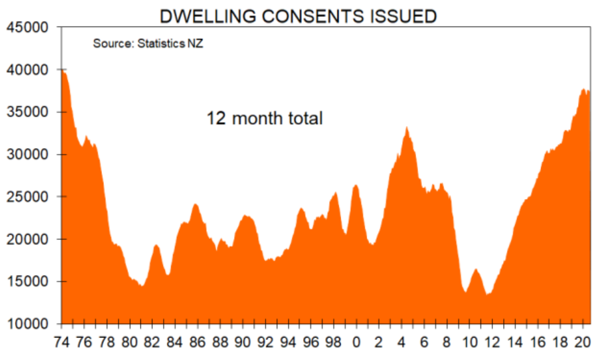
Some of the ads I receive for inclusion in the Work Ads publication which accompanies each week's send-out of Tony's View and Tview Premium show this shortage. Employers in Wanganui in particular seem to be eager to find people.

House Building

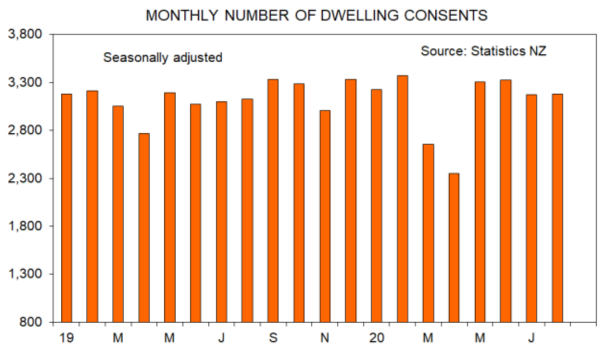
I am increasingly of the view that this sector is going to experience one of the mildest recession hits it has ever seen.

The recessions of 1991 and 1997/98 saw house building volumes decline by 17%, and the GFC produced a 34% fall. This time around a pullback of 10% may be all we see – and so far, one struggles to find anything beyond some anecdotal evidence which by the day is getting swamped by opposing anecdotes on the positive side.

As the Prime Minister recently noted, the number of consents issued for the construction of dwellings is so far sticking near the high levels seen as we entered the Covid-19 shock. Consents totalled a 45-year high of 37,800 in the year to February and still stood at 37,400 in the year to August.



Because consent issuance is the last thing to happen before construction starts, this data series is probably not as forward looking an indicator as one might think. But we don't have data on resource consents or such-like and it still seems reasonable to think that the series will fall away over the coming year before recovering again. Some of the most recently monthly strength will also be simple catch-up after the lockdown effect over March and April.



Why is house building unlikely to fall away sharply? It is not just the record low level of mortgage interest rates encouraging people to borrow and build. Investors facing low returns on most investments are veering toward building to let. And faced with a worsening shortage of listings and prices for existing houses running away on them, owner occupier buyers are turning toward contracting to get a property built.

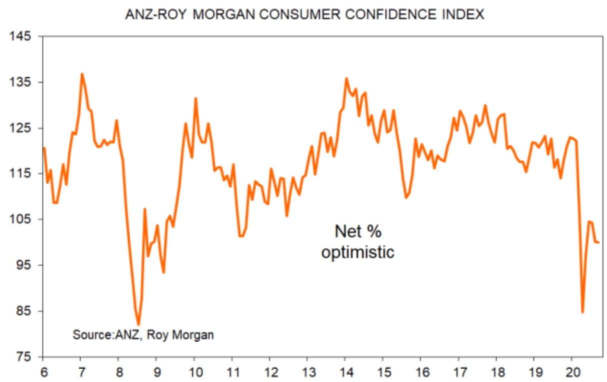
We should also not forget the growing state house building programme.

These developments are leading to hefty demand for developable land in Auckland in particular, but also in many other parts of the country.

This is definitely not what we normally see when we have a recession.

Consumers Not Despondent

Just in case you have been thinking that the recent lockdown in Auckland would cause consumer sentiment to fall sharply again as it did in March and April – rest easy. The ANZ Roy Morgan Consumer Confidence Index held steady at a neutral reading of 100 in September. However, this was well down from the ten-year average of 119 and the 122 level in February.



In the short-term, changes in these sorts of confidence readings are poorly correlated with changes in spending. But they do matter, and one gauge of the underlying ability of the economy to sustain some of the strength it is displaying across numerous sectors at the moment will be whether this and other measures, such as those in my Spending Plans Survey, improve over Spring and Summer.

The most up to date measure of consumer spending which we have is the Electronic Card Transactions series from Statistics New Zealand. It is monthly and has a history of high volatility, so results do need to be treated with caution. Plus, there is clearly a downward bias associated with the March – May lockdown, then an upward bias associated with catch-up spending, and a probable downward bias again as that spending reverts to normal which will be less than the monthly catch-up months.

Core spending fell 45% in April then rose 73% in May, 15% in June, and 1% in July before falling 7%. If we knew what normally happens during and after lockdowns, we could perhaps say something intelligent here. But we don't. Therefore, much as I like to take a positive interpretation of many things there is really no basis for either smiling or frowning with regard to consumer spending levels overall recently.

What is more interesting are the patterns, with soaring purchases of durable goods completely at odds with what we know happens during recessions. Normally, we pull back on buying spas, pergolas, artwork, couches, carpet etc. when times are tough. This time around, with cash to spare from not travelling overseas, and a new focus on our home nests, we are spending up large on big items.

For retailers and manufacturers in those sectors some caution would seem warranted regarding 2021. There are only so many new furnishings etc. which householders can reasonably buy and having bought them the cycle usually kicks down the other way.

Export Prices Are Good

Speaking of things holding up – international commodity prices for our exports have failed to fall away as usually happens when the world goes through a low growth period.

The ANZ Commodity Price Index in world price terms has eased just 2% over the past two months to sit only 1.5% below its level in February and 3% from a year earlier.

Export prices fell firmly during the Asian Crisis and GFC. But this time around, during a period when many people have been talking about the worst economic conditions since the Great Depression of the 1930s, frankly, New Zealand is getting off lightly.

TONY'S VIEW

New Zealand's Housing Markets

The New Housing Boom

This week I spent a few hours with some people filming a long item for an upcoming analysis of the NZ housing market. The focus was (will be) on why conditions are so strong at the moment. A few weeks ago, on September 17 I produced a list of 25 reasons why housing is strong and house prices are rising. I didn't run through all 25 for the interview, but instead here are the seven main points I strived to get across. Hopefully my piece doesn't get condensed down to just ten seconds!

Interest rates

There are four ways in which interest rates help explain the current and coming market strength.

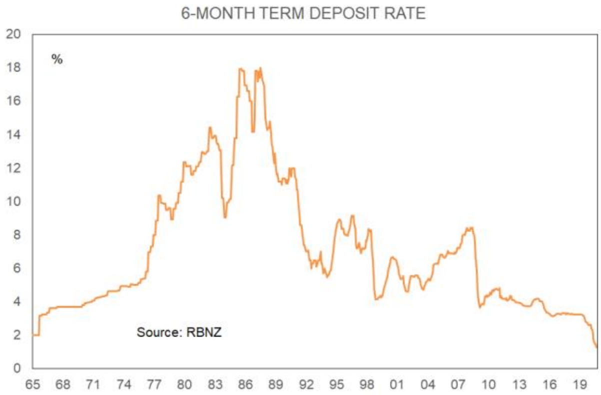
1. The Reserve Bank cut the official cash rate 0.75% to a record low of 1% last year, and lower mortgage and term deposit rates encouraged a new flow of buyers into and reduced flow of sellers out of the residential property market. The RB cuts cemented in the turning of Auckland's cycle from its flat period to upward and added strength to the regions.

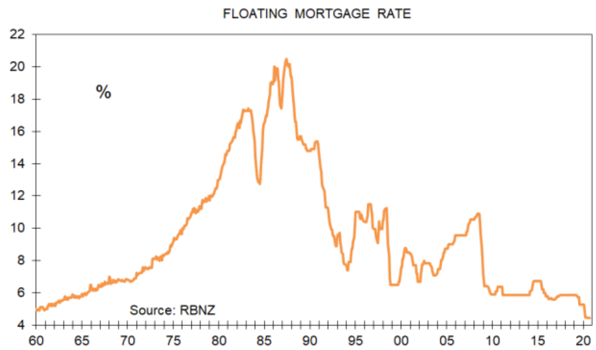
2. The RB again cut its cash rate 0.75% in March and this has again enervated buyers and discouraged people from selling and accepting lower returns from the likes of term deposits.

3. Expectations have heightened that interest rates will remain at low levels for many years. Traditional fears of a bounce back in rates to previous cyclical highs have disappeared.

4. The Reserve Bank has indicated that there is scope for their cash rate to be cut by perhaps another 0.75% next year – again driving more people into and fewer away from the property market.

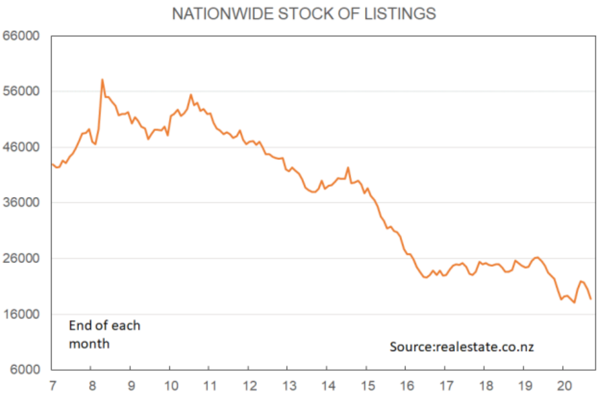
Here are a couple of graphs – one starting in 1965 and the other in 1960. The good old days!

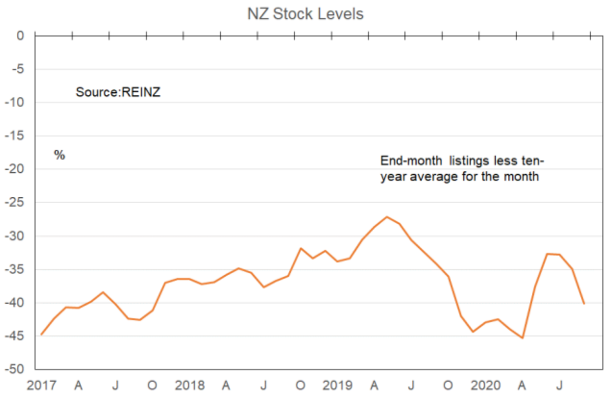




Shortages and Pent-Up Demand

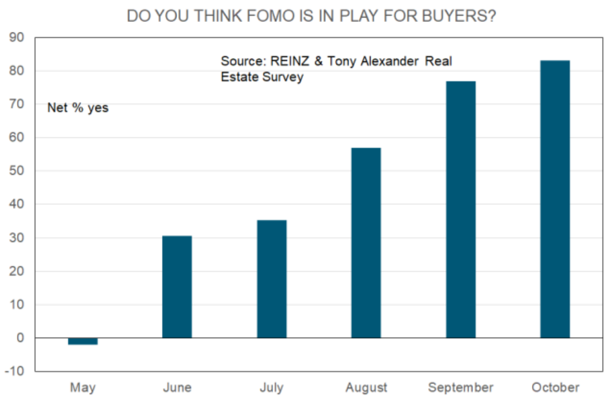
In February the number of properties listed for sale in New Zealand was down by 21% from a year earlier and 63% from ten years earlier. At the end of September this shortage had barely changed, with listings down 18% from September 2019 and 65% from September 2010.





FOMO

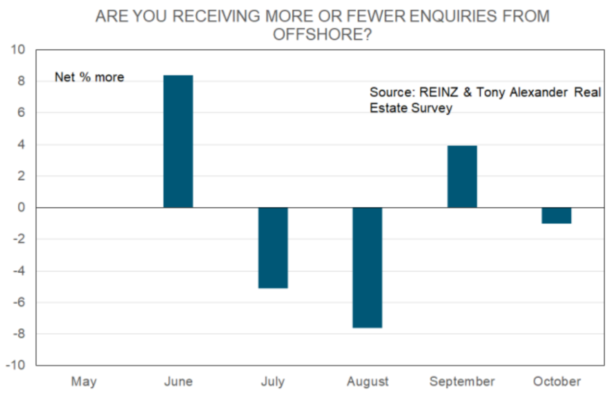
There is now so much awareness of a shortage of listings, absence of falling prices, and scrambling for properties by people attending Open Homes and auctions, that buyers are very fearful of missing out on making a purchase. The REINZ & Tony Alexander Real Estate Survey for October shows that a net 83% of real estate agents around New Zealand feel that FOMO (fear of missing out) is in play. In May this proportion was a net 2% feeling this sentiment did not exist.

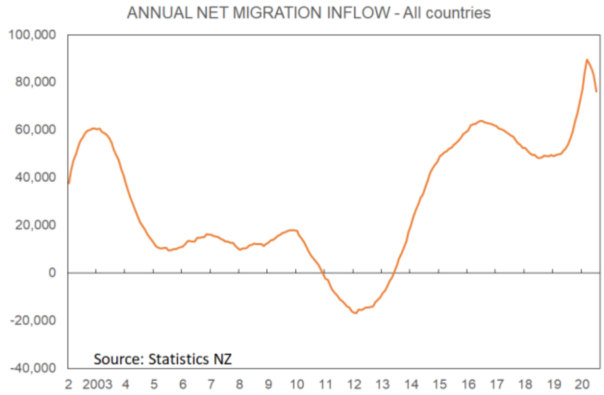


Migration

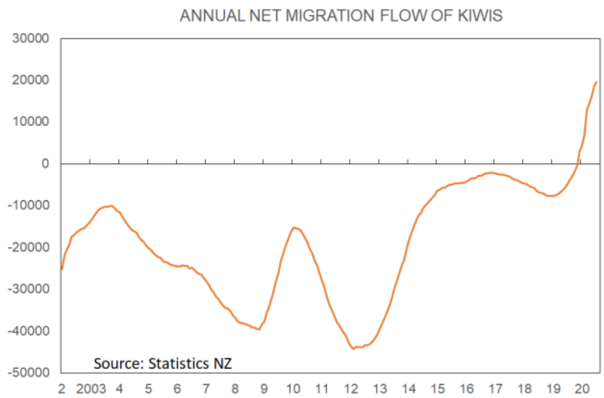
It is true that with borders closed the monthly net migration flows are near zero – and it is true that every person and commentator who has focussed on this fact and adopted a negative view on the property sector has been wrong. They have neglected to realise two key things.

1. There was a record net migration inflow ahead of lockdown, amounting to a net 90,000 in the year to March. This is almost three times the average net inflow for each of the past ten years of 33,000 and 50,000 a year earlier.
2. We Kiwis suffer a brand of cultural cringe which means we pay particular attention whenever anyone outside the country notices us and tend to blow out of proportion the actions which they might take upon noticing us. Generally, that means we expect anyone disgusted with President Trump to shift here – same for Brexit, Australia's bush fires, climate change effects generally, and so on. In reality there is no massive flow of Kiwis back to New Zealand escaping Covid-19 offshore. A net 1% of real estate agents this month have said they are seeing fewer enquiries from offshore. But expectations of a horde of expats and foreigners heading our way once borders properly open has encouraged "canny" people to make a property purchase now.





And despite what I just wrote about the absence of a flow of Kiwis back here, there has nonetheless been a structural shift in net Kiwi migration flows starting from before we had heard of Covid-19. The following graph shows the annual net flow of Kiwis into and out of New Zealand. The average flow since 2001 has been a loss of almost 20,000 Kiwis per annum. For the first time ever, that flow turned to an annual positive of 2,790 in December last year. The annual flow to July was 19,513, but with net gains averaging only 814 a month since April.



LVR removal

In March the Reserve Bank pulled out all the stops to mitigate the impact of Covid-19 on the economy. One of those things was removing the Loan to Value Ratio requirements first imposed in 2013. The removal is scheduled to end come the start of May 2021, and although we cannot know what the minimum deposit requirements might be, it seems reasonable in light of the booming housing market, to expect that LVRs will be allowed to automatically reinstate from that time.

The Reserve Bank has therefore delivered an incentive for property buyers to act now to try and secure a property with a low deposit rather than risk missing out when LVRs return.

In the words of the RB on April 30.
"The Reserve Bank will monitor lending activity and feedback from retail banks over the next 12 months as the economic impact of the COVID-19 pandemic becomes clearer. While we've eased the restrictions completely for the next twelve months, we will review the most appropriate setting for LVRs in a year's time."

$10bn

This is the amount which we Kiwis were going to spend travelling overseas this year. Now, we are spending it on home improvements and many young people are likely to have reclassified their spending as a house deposit. They may also have decided in light of Covid-19 circumstances, to switch around their home buying and travel plans to purchase a home first and then travel, rather than the other way around.

Their ability to see an achievable house deposit will have been enhanced by their experience of savings building up during the lockdown when spending on going out in particular was not an option.

Nesting

Covid-19 has scared people into staying home. For many that means boosting spending on home improvements to make that home nest feel more comfortable, and perhaps just to shout oneself something tangible and long-lasting during these uncertain times.

But for others the desire for better living conditions manifests itself as a decision to make a purchase – either of one's own home, or of an alternative designed to be more suited to one's desires than the one a person spent seven weeks locked up in during lockdown.

Interest Rates

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

There have been no movements of significance in wholesale interest rates this week. In perhaps April next year the Reserve Bank might cut the official cash rate below 0%, and that will flow through to reductions in wholesale interest rates of diminishing magnitude the further out one goes along the yield curve.

However, there is a risk that expectations for a negative cash rate diminish in coming months in the face of potentially better than expected data on the state of the NZ economy. In that case we can expect some small rises in the shorter-term fixed borrowing and investment rates. My inclination is toward this second scenario.

For now though, 90-day bank bill yields remain near 0.3% and the three-year swap rate near 0.07% where it has been since mid-August.

Term Deposits

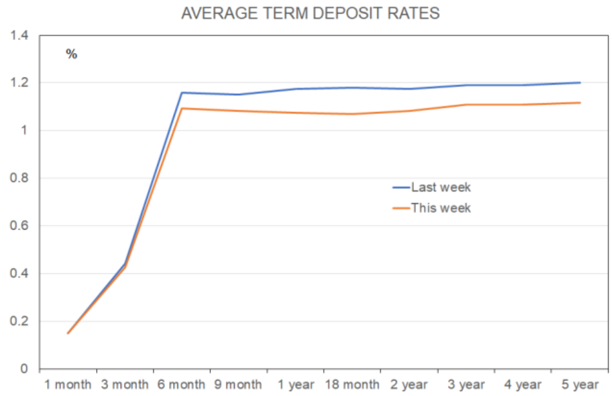
Term deposit rates available to savers have fallen a long way over the past few years. Back at the end of 1990 you could get 12% with the banks for a six-month deposit. That fell to about 6% within two years as inflation fell from averaging near 11% to 2%.

This six-month rate fell to 4% during the Asian Crisis of 1997/98 but was at almost 8.5% heading into our 2008 recession. Come the start of 2010 the rate was back just over 4% and from there it declined to 3% in early-2019, 2.5% early this year, and now 1.15%.

The incomes of people dependent upon simple bank deposits have been decimated and this will impact the quality of their retirements in particular if they were not diversified into equities and/or residential property.

What will happen now? Will the banks suffer a large-scale withdrawal of funds by depositors? No. This has not happened overseas in countries where rates had already fallen to exceptionally low levels ahead of the Covid-19 crisis. Most people will simply grin and bear it, hoping that if the Reserve Bank takes the official cash rate negative next year (I am yet to be convinced they will) that they won't be charged by the bank to look after their money.

Perhaps this is why despite the absence of any changes in wholesale interest rates recently banks continue to cut their term deposit rates. The average 90-day rate this week has fallen to 0.43% from 0.55% one month ago and 2% back in January just before the Reserve Bank cut the cash rate by 0.75%.



In fact, since April 2019 the Reserve Bank has cut its cash rate by 1.5% but 90-day term deposit rates have fallen by 2.15% and the one-year rate by 2%.

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