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.

Potential Shocks

"What could go wrong." Those are the words I've been using in a jocular manner for the past five years when in a quick conversation someone at a café or at a function asks me what I think lies ahead for our economy. What I am aiming to signal is that the outlook based on the things which we can see and take a reasonable stab at add up to a positive outlook – but don't be complacent. Shocks always lurk in the wings and we cannot predict what they will be, when they will occur, how bad they will be and how long they will last.

This is exactly where we sit in our economy at the moment. All of us economists and most insightful businesspeople can in a few minutes draw up a good-looking list of factors which will deliver reasonable growth for this year and a few years afterward. Here is one version of such a list.

- Low interest rates – meaning a low barrier to businesses investing more, low cash drain on those in debt, and encouragement for higher asset prices which boost wealth and encourage more spending.
- Strong net migration inflows – which means more people buying stuff and taking up accommodation with upward pressure on house prices.
- High export commodity prices – which means good incomes for farmers mainly and that helps underpin on-farm investment and spending in the regions.
- Loosening fiscal policy – which means more government spending (though we just know the quality of some of it will be rubbish).
- High job security – meaning people don't reckon they'll lose their job or be out of work for long if they do, and that underpins willingness to spend.

And, we can easily draw up another list showing why we don't think a boom can occur – meaning growth not approaching 4% and more probably staying around 2%.

- Tightening credit conditions courtesy of increasingly gun-shy Aussie banks, higher capital requirements being imposed by the Reserve Bank, new stress testing coming for climate change effects (discussed further on), meaning restraint on business capital spending.
- Compressed business margins caused by loss of pricing power – meaning reduced willingness and ability to invest and expand.
- Staff shortages – meaning the physical impossibility of expansion of output for many businesses because they can't find the people they need.
- A general election late in the year – meaning because of uncertainty about what the government will look like (what bastard set of coalition partners, supply agreements and bribes will be needed to form a Government?), people will put large-spending decisions on hold. Housing activity will slow along with business investment and maybe hiring.
- Rising impacts of actual climate change, mitigation efforts, and social pressures for change. High uncertainty bringing more caution with capital spending.

So far nothing new to read. But now let's go back to my opening statement – what could go wrong. Many things of course, and I don't tend to pay excessive attention to them because people have a habit of blowing these things out of proportion and over-extrapolating. We can all look at a bush and see tiger eyes staring back at us. It's in our nature. The confident ones who never thought they saw tiger eyes got weeded out of the gene pool.

Anyone who over the past 12 years has fixated heavily on risks surrounding Greek bankruptcy, the Euro collapsing, Brexit, President Trump, Chinese debt etc. will probably have been cautious in their investing. And they'd have missed out on soaring asset prices be they shares or property.

But a couple of things have started to go wrong which we need to keep an eye on.

The big one is potential war in the Middle East and terrorist acts against the United States elsewhere which could bring high oil prices, falling share prices, falling confidence levels, weakening food commodity prices, and overall weaker spending. I have as much informed insight to offer on how this situation will develop as you do – virtually nothing. All we can do is see how things go, adapt to whatever happens, perhaps try to profit from the situation with personal picks on how some asset prices will change, and be a tad more cautious with our spending.

The other new factor attracting some attention is a potential SARS-like (severe acute respiratory syndrome) outbreak sourced so far to a fresh fish and meat market in the Chinese city of Wuhan some 900km north of Hong Kong. Maybe it is, maybe it isn't. The Hong Kong authorities have already boosted passenger health surveillance on incoming planes and trains. Should an outbreak be confirmed we can expect a depressing impact on international travel. This matters a lot to us because our foreign tourism growth rate has already stalled after five years of polluting growth, flight-shaming is growing in Europe, and Middle East war would boost fuel costs.

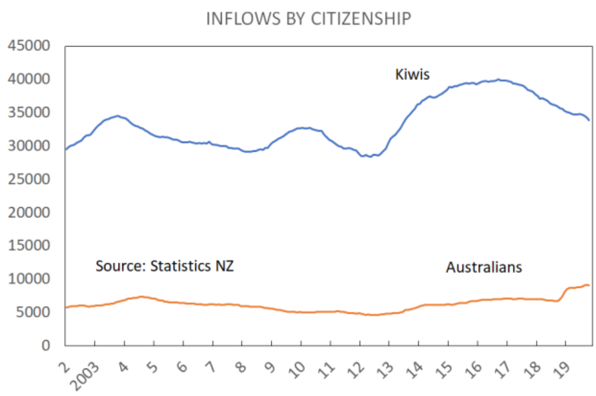
If things deteriorate for both these risks, what might we see happen? Lower interest rates for longer and enhanced net migration to New Zealand. These two factors will tend to boost house prices. But there would be offset from weaker economic growth, reduced job security, and higher fuel prices.

These are early days yet for both shocks and all we can do really is wait and see what happens. One offshore economic forecasting group is picking 0.5% coming off global growth following a hike in oil prices to US$150 a barrel should war break out. Others pick a move from around $65 to $80 then easing back if attacks are of limited nature within Iraq. It all depends on what escalation is coming. Thankfully, as of today, the degree of escalation seems relatively minor.

Kiwis Returning?

During the holidays a real estate agent made the claim that business is picking up partly because of an increase in the number of Kiwis returning home. Do the data back up this claim? No, but maybe his nose on the ground is more up to date that the fairly old Statistics NZ migration data.

The following graphs shows the annual number of people shifting to New Zealand who have Kiwi citizenship – the blue line. The trend has been downward since 2017 and no turning in this only slightly cycling series is evident.



I've also plotted the annual number of Australian citizens shifting here. The late-2018 lift comes from a weird blip late that year, but there does appear to be a small upward drift. It will be interesting to see if this persists following their bush fire season, whether we see some Australian farmer interest in NZ regions because of their drought conditions and decline of rural towns, and whether we see a lift in Australian visitor numbers here following decimation of bush around some tourist towns. Maybe some people who were contemplating shifting to Australia from NZ will be dissuaded, and maybe non-Australasians who were planning to migrate to Australia will come here instead. I've no particular insight to offer on any of these things individually, but collectively they fall on the side of better net migration numbers for NZ over the long-term.

A New Restraint on Bank Lending

This restraint won't be hitting this year, but will come down the track as the human response to climate change intensifies. On that note, Sunday night at 7.30pm I now devote to watching the new David Attenborough-narrated series "Seven Worlds, One Planet". In the first episode there is a comment he made which was quite stark. It wasn't about the number of dying species, degraded environments, or suffering animals. It was along the lines that we humans are changing the world.

That has been a desire and call to arms of many campaigners for many decades – let's take some action about something and change the world. But we have changed the world, not through organised action, but simply through living, spreading, and populating in an unsustainable manner. We are changing the world – for the worse. In technical terms – huge anthropogenic change.

Last year I began introducing comment on the negative impact of how we are changing the world with the aim of raising awareness not just of the physical effects (inundation of coastal, pluvial, and fluvial varieties), but of the changes which will increasingly be forced upon us through legislation and societal pressure.

Eventually, an overlay of climate change impact awareness, mitigation, penalties, and altered behaviour, will be placed across everything we do. Investors, property buyers, and businesses need to increasingly give thought through 2020 as to how the coming changes will affect them.

And so, here is one coming change starting at a really low simmer.

Around the world this year central banks are rolling out something new which in the end will further reduce the amount of credit available to our farming sector along with any other sector with high levels of emissions. Plus, it will eventually reduce credit available to businesses and locations most at risk from the effects of climate change – drought, inundation events etc.

It goes like this. Banks are going to have to run a new set of stress tests – tests aimed at examining how they will fare if certain things happen. To date these tests have centred around a scenario involving the likes of house prices falling 40% and the unemployment rate going to 10%. Now, presumably in addition to these tests of the adequacy of their capital bases, banks will need to assess the impact of a range of climate change scenarios, and the possibility that major and quick changes are made to try and mitigate further global warming – new taxes, levies, bans on activities etc.

The Bank of England as an example will require banks to model the effects of three scenarios.

1. Early action and "only" 2 degrees average global warming.
2. A decade's delay of action then fire sales of assets affected by rapid policy changes.
3. No action and 4 degrees warming.

In April apparently, we will learn the standardised tests which central banks will apply around the world.

These links are relevant to the UK, France, and US.
https://www.ft.com/content/bacdb162-217e-11ea-92da-f0c92e957a96
https://www.insurancejournal.com/news/international/2019/12/02/549827.htm
https://www.bankingdive.com/news/big-banks-climate-stress-tests-senate-bill/567792/

The outcome of the tests may eventually entail some mix of higher capital, repricing of lending to at risk sectors, and reduced availability of lending to some sectors.

But there is more to come. In Australia the corporate regulator of listed companies (ASIC, the Australian Securities and Investments Commission) has announced that from this year for the first-time companies will need to tell shareholders and customers about the risks to their firms from climate change.

The timeframe is unclear but the message isn't. You need to explicitly take climate change into account when you consider your investments, your home purchase, and your business. Is your location at increasing risk of inundation be it pluvial, fluvial, or coastal? One day you might not be able to get insurance, and potential buyers may not be able to get a mortgage. Do you own shares not just in sectors like oil, gas, and mining, but tourism, air travel and its servicing?

And, one more simple thought this week. At some unpredictable stage voters will capitulate in their opposition to climate change policies which will negatively affect their standard of living. Acceptance of lifestyle changes and imposts to help fight climate change will drive actual policy changes.

But those policy changes will be muted by resistance from industries most affected by alterations – coal mining, oil, even farming. And they will also be muted and delayed by the historical association between the conservation movement and left-wing activists which has generated substantial distrust amongst the populace and business community in particular of those pushing policies aimed at assisting struggling ecosystems.

The challenge for voters determined to get changes made will be to accept that compensation will need to be paid to those most affected by the new policies. This might take the form of relocation assistance (people and businesses), income supplementation, paid retraining etc.

Until largely city-based voters pull back from criticising those in newly defined "polluting" industries and expressing hate and disgust at the idea of assisting them to flourish in a changing world, actual policy changes at the national and international level will be vastly watered down by opposition from politicians representing those people. Especially using their ability to influence who governs in non-first past the post parliamentary systems.

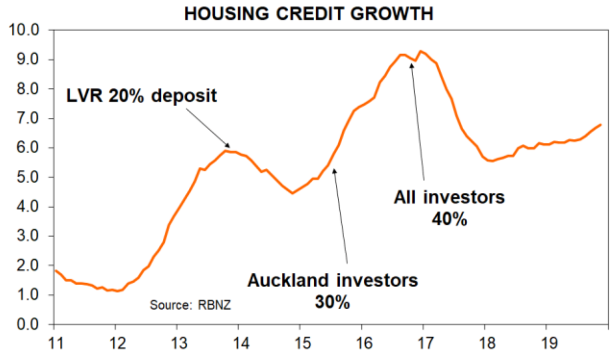
Housing Market

I could have started my writing about New Zealand's housing market for 2020 by repeating analysis of the latest data already written in TVs of late-December and summarising the many factors which I believe will propel prices higher. But instead I decided just ahead of Christmas to produce something for the worriers. These might include some of the people who have been wrong about our housing market since 2008 and are still hanging out for those people who have seen their wealth rise by purchasing houses to finally get their comeuppance. Funny how if you achieved the same or greater rise in wealth this past decade by purchasing and holding shares you attract no criticism.

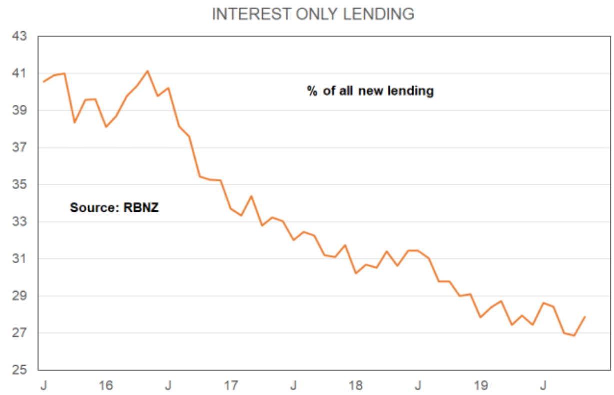
So, what I've done below is produce a body of graphs showing changes in the riskiness of lending to home buyers. These are the graphs which I shall look at every few months to gain insight into whether the Reserve Bank might be thinking about curtailing the housing market rise by tightening LVR rules and pressing more strongly for a debt to income tool.

The data all come from Reserve Bank statistical releases based upon data supplied by mortgage lenders. Many of you will be pressed for time and most of us simply gloss over graphs when included in an article so let me save you all the effort and note that at this stage there are some ratios going in the higher risk direction. But the speed of change is slow, the levels look low, and there seems as yet nothing much for the RB to be worried about. Mid-year might be more interesting however.

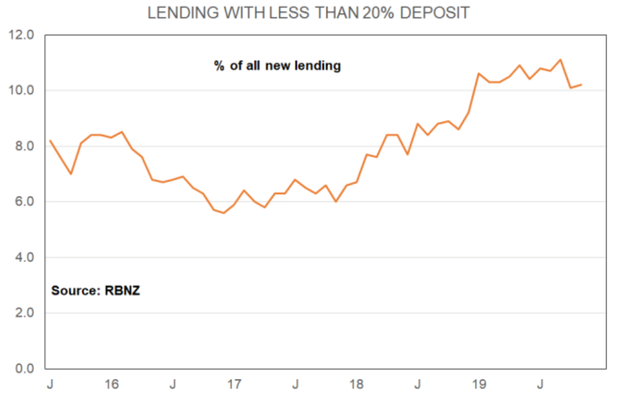
The annual rate of growth in lending for housing purposes rose to 6.8% in November which is the highest pace since the middle of 2017. It's not a "take-off" by any means and won't scare the Reserve Bank. But it does suggest the chances of any additional LVR easing are now very slim. Having said that, the RB will look closely should we get more specific months like November where the volume of outstanding housing debt jumped by $1,888mn. Only three other months have ever shown slightly higher increases.



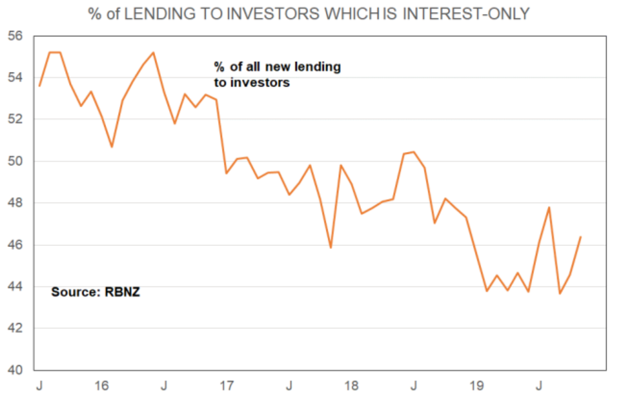
Can we look deeper into the data however and find trends with regard to interest-only and low deposit lending which might concern the RB? No. The proportion of housing lending which is interest only has not started trending upward.



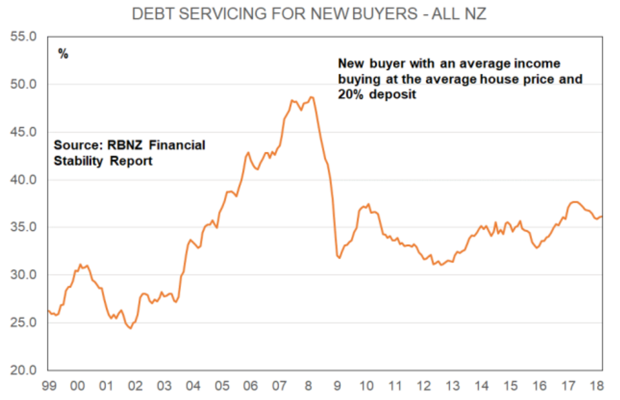
There is no upward trend in the proportion of lending undertaken with less than a 20% deposit.

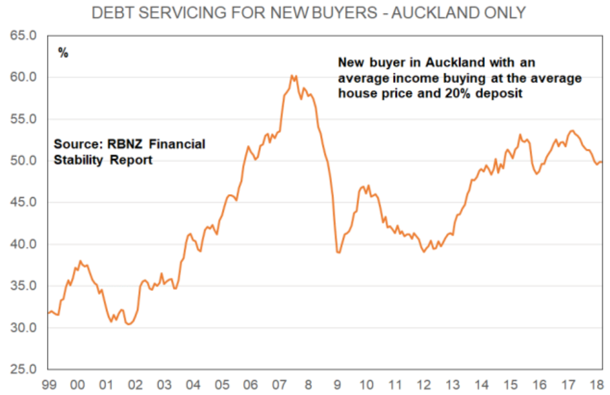


There is a flattening but no upward trend yet in the proportion of lending to investors which is interest only.



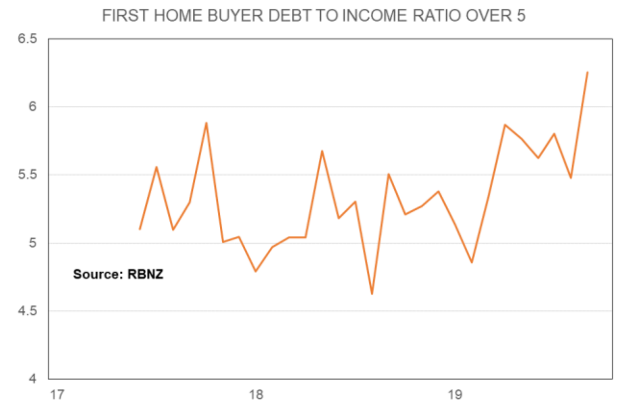
And using data supplied by the RB in their six-monthly Financial Stability report, we can see that there is also no upward trend in the debt servicing cost of the average buyer with a 20% deposit for NZ overall or Auckland only.



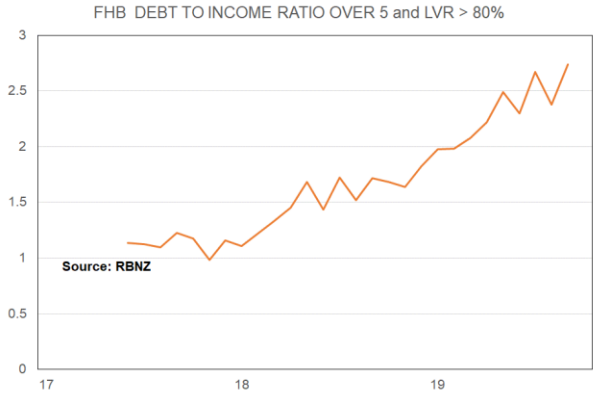


The Reserve Bank since the middle of 2017 has required registered banks to supply it with data showing the total debt to income (TDI) ratios of new borrowers. This is a wider concept than the commonly written about debt to income ratio (DTIs) as it includes all debt assessed by a bank when making a loan – the mortgage itself plus credit cards, hire purchase etc. The data are only available for first home buyers and owner occupiers, but not investors. The problem with investors is that they either choose not to supply full income data or are not asked to once minimum requirements are satisfied. In other words, calculated DTIs for investors can look much higher than they really are. This tends not to be the case at all for first home buyers and probably not much for Owner Occupiers – people usually shifting house.

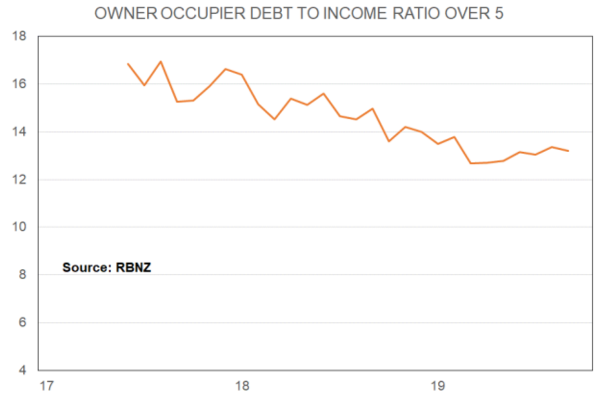
Our first graph shows there is an upward trend in the proportion of bank loans going to first home buyers with TDIs above 5. Riskiness is rising.



The rise is mainly happening it seems for lending to those FHBs with less than a 20% deposit.



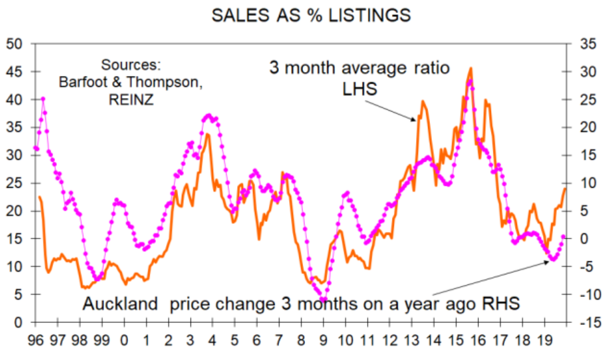
There is a downward trend in the proportion of lending going to non-FHB owner occupiers.



Barfoot and Thompson Auckland Data

Next week I shall take a look at the realestate.co.nz data released a few days ago showing listings levels around the country. But this week I'll briefly mention December data released yesterday by Barfoot and Thompson. Their Auckland sales in the month of 779 units were the highest for this traditionally weak time of the year since December 2015, and 54% up from December 2018's 504. Average sales prices were ahead 3% in the December quarter – consistent with other measures and showing average prices now at new record levels. Their stock of listings is 24% down from a year before. New listings over the quarter were down 10% from a year before.

Basically, buyers have soaked up a lot of stock late in 2019 in Auckland, but it's too soon to say that a good flow of new listings is coming in. If they don't then price rises could be quite strong this year. This is what one of my long-standing favourite graphs tells me. Note the orange line showing the ratio of sales to listings rising strongly, and how the pink-dotted price line tends to follow it.



Interest Rates

Some people might soon try to run an argument that tighter monetary policy beckons. They will likely cite rising oil prices, accelerating house price inflation, improving business and sentiment, and easing fiscal policy. However, higher fuel prices tend to act as a growth-supressing tax, and with automatic links between cost of living changes and wages growth broken these past 2 - 3 decades, if anything higher fuel prices (should they come) will encourage lower borrowing costs.

Higher house prices are occurring without much noticeable lifting of risky bank lending. So, the Reserve Bank won't be thinking about raising the official cash rate to stem risk growth.

Confidence levels are highly volatile. But perhaps more significantly, across the Tasman they are newly falling in response to the bushfire concerns. That is propelling rising expectations in Australia of easier monetary policy in the next few months. The relevance here is that this increases the chances of the NZ dollar pushing closer to parity against the Aussie dollar and that will tend to depress NZ inflation.

Easier fiscal policy will take quite some time to hit the ground.

For borrowers the outlook for 2020 remains one of continuing low interest rates. The turning around of fixed interest rate prospects which we saw late last year assisted by diminishing expectations for lower rates offshore may pause for a while now in light of worrying global developments.

For term depositors the outlook remains bad. Hence the risk that the rise in house sales does not elicit a rush of new listings because as so many people now comment – what will they do to get a decent return from the proceeds of any house sale?

CHOOSING YOUR FIXED MORTGAGE RATE TERM

The year starts with minimum mortgage rates still at unchanged levels. So, if you've read this section at any stage in December, don't bother reading it again – unless you've forgotten what it said.

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	3.55%
3 years	3.89%
4 years	3.99%
5 years	4.09%

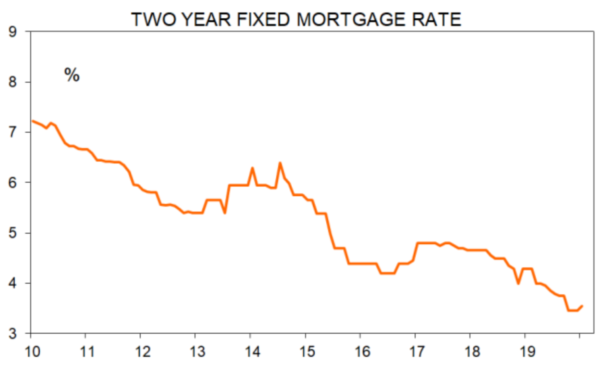
I can fix 1 year at 3.39%.

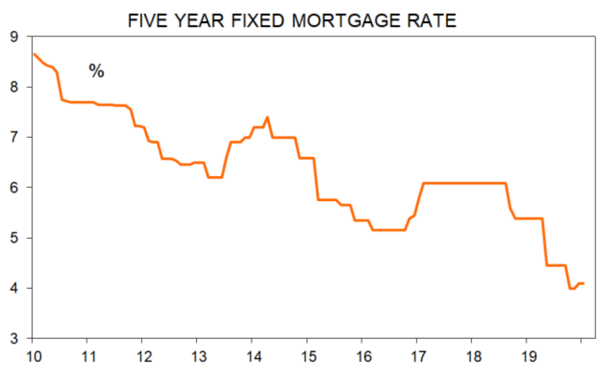
Is this better than fixing 2 years?	Yes, if in 1 year the 1-year rate is below 3.51%.
Is this better than fixing 3 years?	Yes, if in 1 year the 2-year rate is below 4.14%.
Is this better than fixing 4 years?	Yes, if in 1 year the 3-year rate is below 4.19%
Is this better than fixing 5 years?	Yes, if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



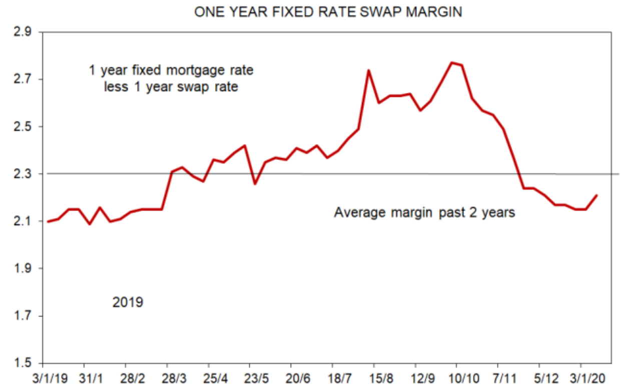


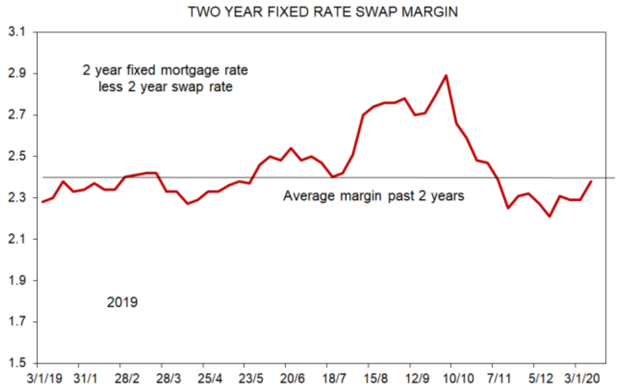
IS A FIXED RATE CHANGE IMMINENT?

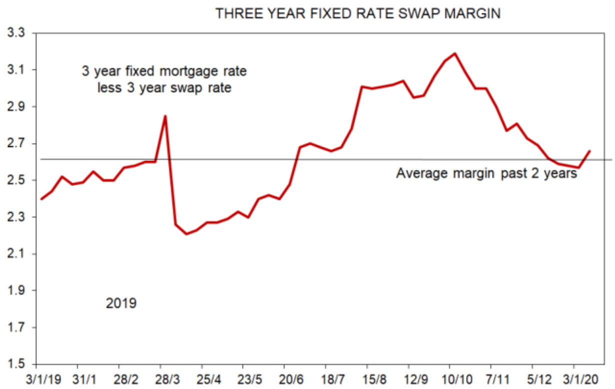
Margins were slowly falling and banks were slowly, sporadically, raising their fixed lending rates late last year. But Middle East tensions have caused wholesale fixed borrowing costs to ease and this has taken pressure off banks at the moment to raise fixed mortgage rates further.

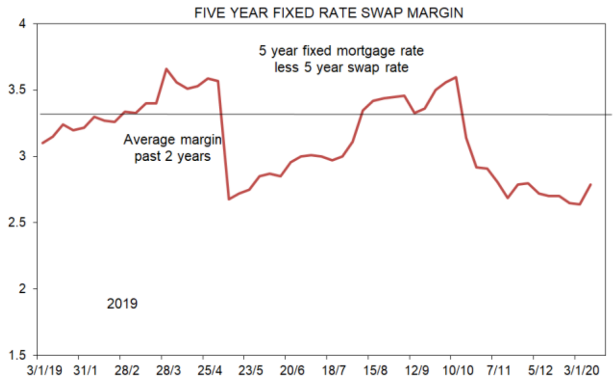
Tony's View

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









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

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DETAILED GRAPHS ENLARGED