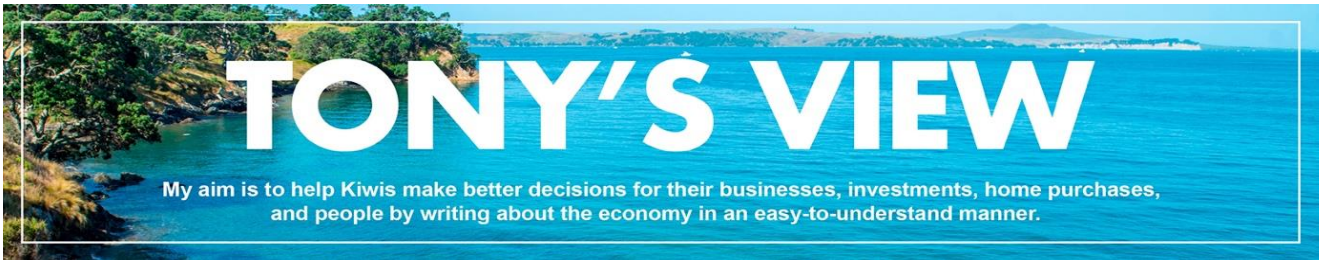


Input to your Strategy for Adapting to Challenges
Feel free to pass on to friends and clients wanting independent economic commentary

ISSN: 2703-2825 Thursday 1 July 2021

Outlook for the economy

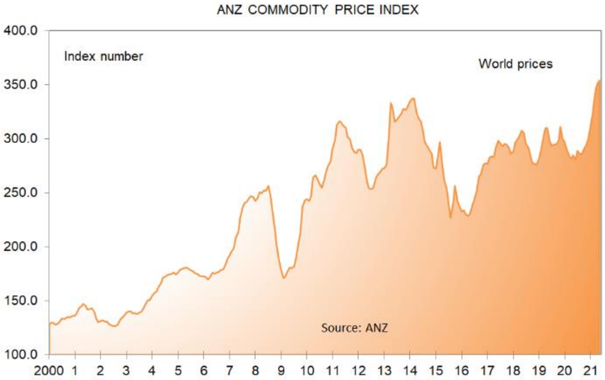
NZ growth prospects are good, driven by many positives

I've not recently had a run-through of the main factors likely to be in play for our economy over the next three years, so let's do that exercise this week. The starting point for a summary of where our economy is going to go has to be exports.

A very high proportion of everything we export from New Zealand is made here. The impact on our economy of a change in export receipts is far greater than in most other developed economies where a high proportion of the value of goods exported is imported, processed, then moved on.

Clearly international tourism receipts right now are minimal. But perhaps a year from now when vaccinations are far more widespread, we can look forward to foreign visitors returning in fits and starts. That will be a net positive for our economy. Perhaps at the same time in more sporadic manner we will see foreign students starting to return also.

The prices being received in world price terms for our minimally processed commodity exports are running over 19% ahead of levels at the end of 2019. The chances are good that these prices will rise further and that volumes will grow, given the positive outlooks for growth offshore.



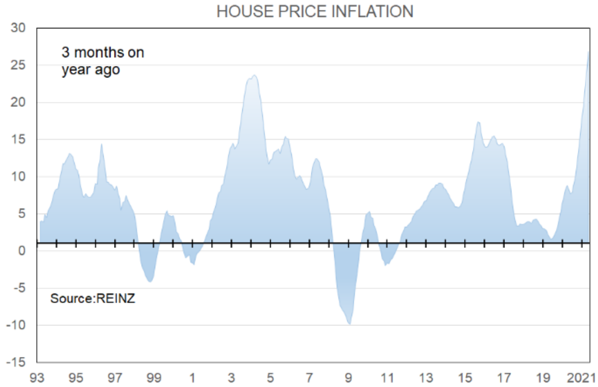
Data coming out of the likes of the US, UK, Europe, and China show good growth and an apparent determination by people to get out and spend to recapture lifestyles they enjoyed before Covid-19. That implies good demand for our dairy products, wine, fruit, red meat etc. Also, as is happening in New Zealand, there is a building boom underway in many other countries. That means high demand for our logs.

In these very uncertain times in which we live it is impossible to place any faith in a forecast for when export receipts will peak then undergo one of the declines which inevitably comes along. But it seems reasonable to be positive for up to the next three years.

The second port of call when considering our outlook is household spending. The confidence levels of you and I are good and according to my monthly Spending Plans survey we are increasing our plans to spend. The jobs market is strongly in favour of employees and high job security along with jobs growth tends to underpin consumer spending.

Bank accounts are flush with cash we might, or might not, spend

We have about an extra $7bn sitting in our bank accounts above what would have been the case without Covid-19. Plus, property owners have enjoyed a 30% rise on average in the market value of their assets this past year and that hike in paper wealth will tend to keep our spending willingness high.



There is also the need to put furniture etc. into the many new houses being built. Plus, with the Baby Boomer generation still running through their stage of entering retirement, there is extra renovating, refilling of houses, and purchasing of new little cars to be done to see these people through their retirement years.

There is some offset to these factors from reversal of the binge we have undergone in spending on durable items as we've reallocated money we were going to spend on international travel. But overall, prospects continue to look good for household spending.

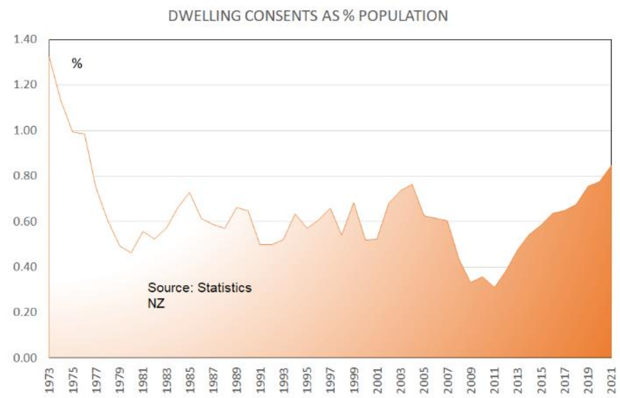
Businesses have a lot of capex to do be it to supplant absent labour, or meet new regulatory requirements, or simply to modernise

Next cab off the rank when considering the growth outlook is business investment. Businesses cannot find the labour they need and will have to invest in productivity-enhancing technology which is something the government will be hoping happens as they cut off the flow of foreign labour desperate for residency and willing to put up with pay and conditions, we Kiwis have demonstrated we won't easily accept.

There is also catch-up capital expenditure to be undertaken, spending needed on environmental impact mitigation, and a structural lift in investment in materials and storage facilities. This latter development reflects the decline in supply chain reliability.

Loose fiscal policy will also be a growth stimulant. The government has demonstrated that one way or the other they're going to do their best to spend all of the special fund set up to combat the effects of Covid-19 even if that means spending it on things unrelated to the virus.

On top of business investment in new storage and distribution facilities, we also have a multi-year lift in infrastructure spending underway at the central and local government level. Plus, we have the biggest house construction boom in place since the 1970s.



Add all of these things together and we're really going to have to dig deep on the next stage of this analysis to deliver anything other than a stellar outlook for our growth. That next stage of course is the negatives.

The main restraint on growth is not low export demand or inflation risk, but lack of capacity

Those negatives include the following.

Interest rates being lifted from extraordinarily low levels used to fight a deflation scare in 2019 and the global pandemic in 2020. The structural factors which have produced surprisingly low inflation since 2009 have probably not changed. Therefore, the chances are good that the extent of increase in interest rates this cycle will not be great. Assuming a 2% rise in the Reserve

Bank's official cash rate seems reasonable, stretching from the start of 2022 into 2024.

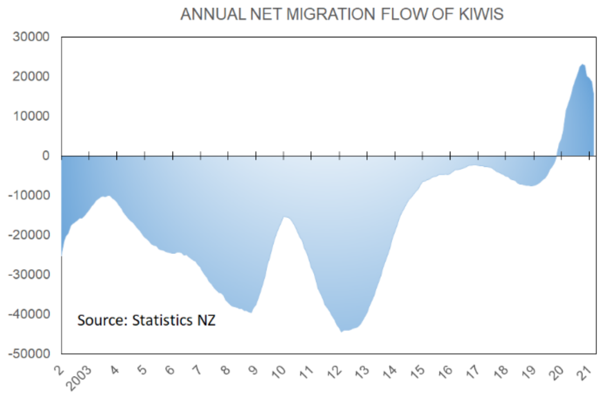
Supply chain problems are curtailing output simply because materials are not available. This factor is likely to get worse as this year proceeds. But eventually the problems will be fixed so the impact of this restraint is likely to be temporary – but stretching well into next year still.

Rising interest rates will tend to lift the NZ dollar. But because rates increasingly look like they will be rising offshore from not long after they start rising in New Zealand, the extent of NZD appreciation is likely to be mild this cycle.

Employee shortages are already constraining output and this effect is likely to worsen. This is not just because businesses have been lax in training people up for the past couple of decades, preferring instead to get staff from overseas. It is also because the Australian economy is looking strong and that will encourage a lot of Kiwis to do what we have previously done when their labour market is a lot stronger than ours. We shift west.

In addition, with strong growth prospects in other countries we traditionally shift to or are already working in, we cannot rule out our net migration flows turning negative next year and maybe for a couple of years after that.

Forecasting net migration flows is hard at the best of times and almost impossible now given the shocks to flows caused by Covid-19, the government's focus on a new migration policy, and a turning of the unusual switch in the Kiwi citizen net migration flow into positive territory before Covid-19 struck.



The various uncertain factors will interact in their usual uncertain ways, but on balance suggest that it is reasonable to have a good outlook for our growth in the next three years.

But it is also reasonable to expect that our business sector is going to go through even more difficulties than they have experienced so far. Labour availability will worsen while labour wage and non-wage costs will rise, the need to invest will grow, spending on impact mitigation will have to increase, and a Muldoonist government with an established record of imposing new taxes is likely to come up with some more.

Running a business is challenging at the best of times. But going forward there is going to be outright confusion on the part of many people. Demand will likely be good. But finding resources to meet a good portion of that demand in a timely manner with good quality product and service is going to be difficult for many.

NZ & offshore housing

Just because our housing market for the moment is correlated with markets offshore, does not mean their changes heavily influence us in normal times

During the week an emailer asked about the relationship between our housing market and markets overseas. He felt that because there was plateauing evident here and in Sydney that our markets might somehow move together. That is not the case.

First, each Aussie state capital housing market has special characteristics usually related to the inner-city apartment markets where investor trading is far greater than anything here.

Second, anyone extrapolating developments offshore strongly into the NZ housing market got their predictions terribly wrong in the GFC.

Third, our housing market has been 2-3 months in advance of markets offshore in the likes of Australia, because of our successful eradication strategy. That success meant we began focussing on the low interest rate and absent foreign travel impact on our personal housing ambitions before the same factors started sweeping through offshore.

Fourth, there are very few people who actively trade or compare housing markets in New Zealand and offshore.

Fifth, if people really believed our market was greatly influenced by markets offshore then commentary surrounding comparisons of affordability here versus overseas would centre around how long it will take for our prices to revert to a global mean, rather than expressions of woe and angst.

Sixth, our housing market can be uniquely affected by sharp changes in net migration flows which are rarely relevant overseas. This arises because such flows can be a large percentage of our population compared with other countries.

Seventh, since late-2018 the only foreigners able to (openly) buy residential real estate in New Zealand are Australians and Singaporeans, plus a handful of others buying a percentage of units in large developments.

Overall economic trends in the global economy which we take part in will cause some coincidental movements in housing markets. But my key message since late-2008 has been that there are unique characteristics to our housing market which make direct comparisons with markets overseas invalid most of the time.

Not a lot should be read into the fact that most housing markets are rising very strongly now. But that in itself perhaps yields some useful information. The under-building of houses in New Zealand is also something which has occurred in many other economies following the 2008-09 Global Financial Crisis.

The residential construction surges now underway around the world are occurring after a period of below average entry of people into the construction sector. The surge in demand globally for people with the many skills required to undertake construction means that we can expect to not only lose our skilled people to Australia, but to other countries as well.

If I were a borrower, what would I do?

Nothing I write here or anywhere else in this publication is intended to be personal advice and you should discuss your financing options with a professional.

Personally, I would take a spread of fixed rates, not because I think it will minimise my interest expenses these next few years, but because it will give me time to adjust spending and saving in other areas if rates change markedly up or down. I do not put much faith in even my own interest rate predictions currently and am not willing to back them.

NZHL Tony's Thoughts Video

Each week I record a three-minute video for NZ Home Loans and in the most recent one I discuss the true proportion of investors seeking to sell their property in the coming year as opposed to the more emotive percentage threatening to do so. Also, I note strength in employment – something which traditionally supports the housing market.

The landing page for these videos is here.

Links to publications

Tony's View Spending Plans Survey

Spending Plans Survey

Tony's View Business Survey

Business Survey

Tony's Thoughts Vlog

REINZ & Tony Alexander Real Estate Survey

Oneroof weekly column

mortgages.co.nz & Tony Alexander Mortgage Advisors Survey

Tony Alexander Regional Property Report

Valocity Valuer Survey

Crockers & Tony Alexander Investor Insights

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One-off issue of Tview Premium

To receive a one-off copy of Tview Premium for $15.00 incl. GST, being this week's issue only, there are two payment options offered in order to keep admin simple at my end. Be sure to enter your email address correctly as that is where the issue will be sent. All payments received up until next Wednesday night will elicit a TVP of the same date as this TV. All from next Thursday morning will receive the next TVP issue. Any problems, just email me.

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