

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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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.

When does your boom end?

As the economic cycle progresses, or as shocks feed their way through, you and I shift in time our purchases of certain things.

For instance, at the moment people are purchasing, or trying to purchase, houses they had been planning to look for 1-5 years from now. They have brought their purchasing forward for a variety of reasons including lower interest rates which explicitly are aimed at bringing future consumption into the present. Also, with prices rising strongly people are acting to try and beat further price rises they think are coming.

People have also of course brought forward in time their planned property purchases because of closed borders leaving money available for other uses. Rather than travel then buy they will buy then travel.

For consumer goods over the economic cycle, we tend to catch up on buying when we move out of weak times. Then, when those bad times return, we push planned purchases into the future.

Since March or maybe May/June last year we consumers have binged on certain categories of goods not so much because financing costs have fallen, but because the Covid-19 shock has made us focus on our home living arrangements and gaining enjoyment locally rather than in foreign countries.

The sort of things we are talking about here include the following – with many of the items

listed reflecting anecdotes of high sales rather than any official data.

Motorbikes
Spas
Pools
Awnings
Kayaks
Boats
Bikes
Exercise clothing
Fitness trackers
Home gym equipment
Sex toys
Paint
Televisions
PC, printers etc.
Kitchen appliances and whitewear
House furniture and furnishings
Home office furniture
Zoom and working from home software generally
Artwork
Campervans and caravans
Vehicle (4WD) accessories
Baking ingredients
Coffee pods
Garden supplies
Building materials incl. timber, electrical, plumbing
Tools
Cats and dogs
Board games
Homecrafts and hobby kits
Games consoles
Noise-cancelling headphones
Home brewing kits
Books
Table tennis and pool tables
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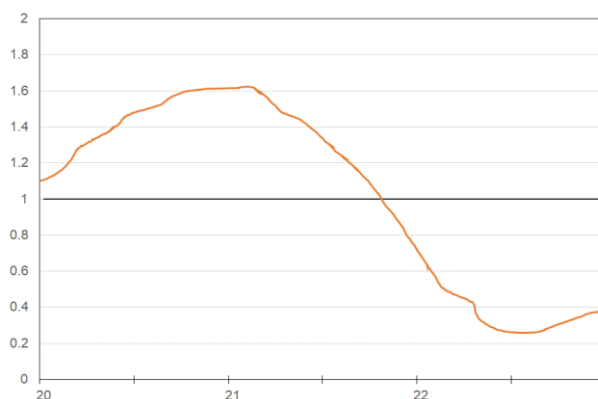
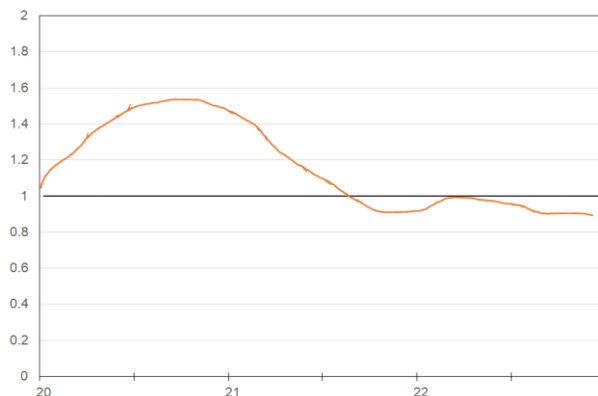
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Broadband routers etc.
Hand sanitiser
PPE
Needles and really little glass bottles
Face beauty products
Toilet paper

Most of these binges cannot continue, even if the borders remain closed for years. The big questions which manufacturers and retailers of each of these items (plus land developers etc.) need answering are these. When will the binge end, and how severe will the pullback be? Will the pullback be right away to a new sustainable level of sales, or as happens with the normal economic cycle, will there be a period of unusually weak sales before averages eventually kick in?

So really, we are asking, will the broad pattern of your sales look like the first graph below, or maybe the second?



The big issues are timing of the boom ending, and whether there has been a structural change in underlying demand for the product. Let's start with motorbikes. When will demand likely fade? When the borders open and we can see ourselves legs akimbo going downhill on a scooter in Italy.

My best guess for that remains the same as since early in this crisis – the start of 2022. Have we shifted permanently to touring the country on



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motorbikes? In decent numbers probably not. Some recent purchasers will look to sell their newly bought bikes come 2022-24 and, in this way, will reduce sales for retailers of new bikes while producing good business for traders in used ones.

What about spas? I think a lot of people have brought planned purchases forward in time and have reallocated this period's international travel budget. That suggests to me quite a weakening in sales with a profile like the second graph at some point – maybe in 2022.

Note also for this product, the shift in the proportion of new houses toward attached rather than standalone dwellings could produce a structural weakening in demand based simply on less room being available for a spa to be fitted. But that is a long-term factor probably lost in the wash for anyone in the sector.

But maybe this factor in the medium term is more relevant for sales of pools as section sizes shrink and fewer standalone houses get built as a proportion of the population. The big risk for pool retailers and others who believe their sales profile will tend towards the second graph, is when our economy next has a recession.

If that happens within the next three years, then I think many operators may have a big problem. But if it happens further out than that, then maybe it will cause only the usual amount of pain.

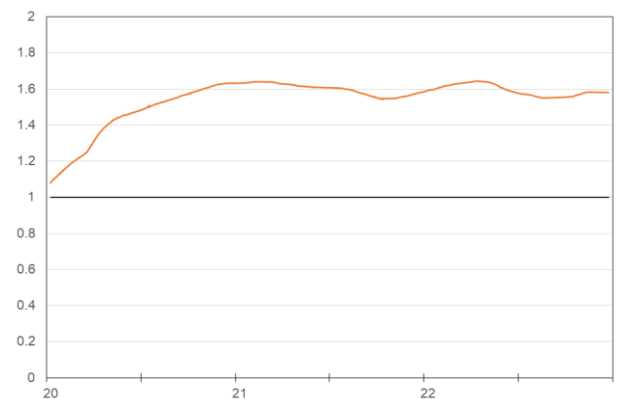
Here's a thought. Once we get back to normal and the years march by again, we're going to be chatting with people and describing some of the things in our possession as the lockdown kayak, the Covid pool or spa. In 2-3 decades, we'll be looking to renovate houses with Covid décor, and we'll laugh, cringe, and wonder when that style might come back in vogue again – if ever. Why so many useless shelf ornaments like coloured pineapples? Whoever needed that many cushions? Oh God, look at the size of their clock Susan! What was this stupid little room for? Oh, a home office.

We economists do not have models or experience in shifts in pandemic spending patterns to be able to give good guidance as to how sales will develop for any of the things which since the pandemic started have experienced boom conditions. But if you are in one of these sectors you will hopefully

have been talking with your clients and so will already have a feel for why they are buying.

If their reasons are temporary, then you'd best bias toward the second graph. But if you feel that much of the surge in buying represents long-term structural changes in what people do, then the first graph would seem more appropriate.

One thing to ask is whether there are any items for which it would be reasonable to instead expect this third graph to prevail.



TONY'S VIEW

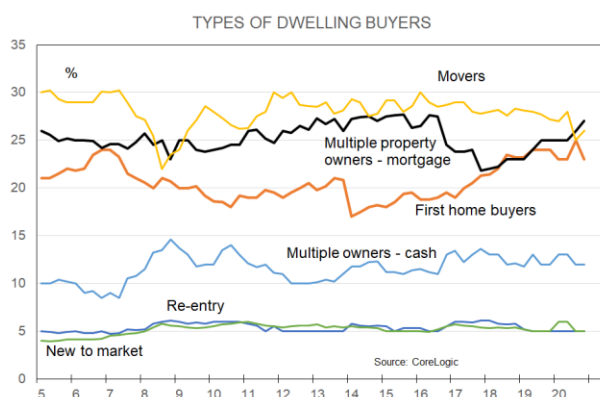
New Zealand's Housing Markets

Sales to investors

The data gathered, analysed in depth, and reported by CoreLogic, give us the only reasonably accurate measure of how many property sales each quarter are to investors versus first home buyers and movers – people simply shifting from one house to a replacement they have just bought. The data used to do the analysis are not as up to date as those from the REINZ when it comes to price because they are based on title transfers rather than sales, but in this context that does not really matter.

The CoreLogic data released last week told us that during the December quarter 23% of property sales went to people who had not previously appeared as owners of property – first home buyers. However, there is an upward bias to this proportion because some FHBs are buying for investment purposes rather than to live in the property.

This process known as “rentvesting” is a method some people are using to get on the property ladder and to build equity for their own home purchase. Most will be buying in expectation of capital gains, though a few may be buying for the running yield.



Nonetheless, let's just call the full 23% first home buyers. This proportion was down from 25% during the September quarter when the data I gather from other sources including the survey I run with REINZ, tell me that investors jumped in boots and all to the residential property market.

In the June quarter, the proportion of sales going to people with multiple properties and having a mortgage on the property, was 25%. This rose to 26% in the September quarter, then 27% in the December quarter – which would have captured a substantial number of sales from the September quarter.

The proportion of sales going to first home buyers has basically been trending up since 2014, and the question we need to ask is whether this recent switch between investors and FHBs represents the end of that trend. I'd say it represents a settling into a new plateau.

There are arguments suggesting sales to investors will fall.

- Increasing power being given to tenants with more likely to come.
- A higher proportion of house sales will be for new-builds and investors have in the past tended more toward existing houses they can do up.
- A generalised move by banks towards a minimum 40% deposit requirement for investors is likely.
- Investors have made good capital gains and some will likely be looking to cash out.

But there are factors suggesting investors will retain their high percentage of sales.

- Interest rates are set to remain low for a number of years.
- There is an increase in build-to-rent activity offering investors an easier route into investment exposure to residential property.

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Wealth Creation

-Anticipation of the return of international visitors and students over 2022 will encourage people to purchase properties for Airbnb purposes and letting to students.

-Many young people will have bought properties because previous plans to travel offshore have had to be shelved. Their planned purchases for 2022, 2023, and 2024 have already happened. Their absence will now naturally reduce the proportion of sales to FHBs in the coming 1-3 or 4 years.

Interest Rates

There is nothing of immediate import to suggest that borrowing costs facing home buyers will be rising in the near future. Central banks around the world have expressed their strong intention to keep official interest rates low for the next 2-3 years in order to achieve two main goals.

First, they want to get the pace of economic growth cracking along by making money cheap and encouraging people to borrow and spend, and businesses to invest. They also hope that asset prices will go up and that this will deliver a dual boost by making people feel wealthier and therefore spending more, and by encouraging extra house and commercial property construction.

That latter factor is probably a big one for our own Reserve Bank and the data certainly show that Kiwis unable to find a used house are buying up sections and signing up to developers' land and house packages as fast as they can.

Second, central banks want to dissuade investors from thinking that inflation will no longer average the 2% which has broadly been the target for the past 2-3 decades. Actual inflation rates have tended to come in on average below 2% over the past decade and there are concerns that if inflation consolidates at too low a level this will raise the chances of deflation when economies weaken.

Deflation can be a big problem because it can raise the burden of debt for businesses as revenues fall but nominal debt loads remain unchanged. In

addition, if people (consumers and business buyers) expect that prices will fall, they will feel incentivised to delay spending until goods and services are cheaper.

This delaying effect can create a hole in economic activity which will push unemployment up and risk producing a new element of curtailed spending.

The upshot is that central banks intend keeping their official overnight interest rates low for a long time. That is not the issue here. The bigger thing is more the risk of medium to long-term interest rates rising a lot earlier than people expect – and this happens every interest rates cycle.

People miss lows for the long-term rates, they stay with the short-term rates, then when those rates get lifted, they can easily run into some big cash flow problems which aggravate the eventual slowing in the pace of economic growth which higher interest rates will one day be aimed at achieving.

All this means is that for anyone looking to lock in a long-term rate because they have one or two inflation worries for further out, the passing of each week brings a higher risk of missing out on the lows.

So far wholesale interest rates have risen from record lows seen in early-November last year with the likes of the three-year swap rate relevant to the cost to banks of borrowing to lend fixed for three years, rising from just over 0% to 0.35%. The five-year swap rate has risen from 0.1% to almost 0.6%.

The US ten-year government bond yield has risen from 0.5% in August to 1.1% now.

So, no need to panic, but just be aware that the central banks (our RBNZ in this case) are prepared to run the risk of over-stimulating inflation some 2-3 years from now because getting inflation back under control is a piece of cake. You just raise interest rates until the borrowers start screaming. And a key issue beyond when this might occur is this.

For every interest rates cycle we never, ever, know how high interest rates need to go in order to get the desired degree of disinflationary pressure. And this

time around, when it happens, we will be dealing with post-pandemic economies for which we have zero experience from earlier years, in an environment when our economic models and experience have completely failed in helping us accurately predict inflation and interest rates since 2007.

Uncertainty regarding medium to long-term interest rate prospects is the greatest it has been for a long time. That is why my personal borrowing conservatism biases me toward favouring fixing

some portion of my debt (were I to have any) at the five-year rate of 2.99%. Good luck.



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