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.

Implications of a capacity-constrained economy

I deliver about 100 talks each year to groups around New Zealand, and occasionally people online through a webinar. For a number of years there is a key theme which I have been stressing in various ways and it lies at the heart of what you need to understand to better alter what you do with your business and investments.

New Zealand's economic history is one of reliance on the primary sector exporting minimally processed commodities to buyers in other countries. Think wool, dairy products, logs, red meat, seafood and so on.

Access to foreign markets is vital and huge attention has rightly been paid over the years to maintaining good relationships with our export destinations, pushing back against trade barriers, and seeking strong enforceable trade agreements delivering long-term market access. Multilateral preferred, but bilateral if necessary.

The memory we have all grown up with is one of an ever-present need to acquire and keep more and more customers for what we product. There has been an underlying assumption that all the resources we need to produce the goods are readily available and once markets are found we can easily utilise supplies of unemployed people, empty roads, ports, and houses to allow production of the goods.

This type of thinking has tended to feed through to all business sectors in the country and led to a typical business model looking like this. You have your product, you know how customers use it and what they like about it, and you strongly believe that if you sell more units you will make more profit.

So, you focus your attention on advertising, marketing, networking etc. in order to secure more orders. Then, when you get the orders in you look for the resources you will need to make them.

In the old days when resources were readily available, you'd be away laughing. Not today. Virtually everything you need to produce your outputs is in constrained supply. You try to find what you need, lobby the government, run scary stories about failure, criticise local authorities, bemoan lazy youth and hopelessness of people on dope, and drive yourself into the ground trying to attain something which is simply out of your reach.

What are these things which we are short of? Here are a few. These are discussed in greater detail in Tview Premium

Labour

Entire sectors in New Zealand have geared their operations around migrant labour and the government is starting to push back against that. The Minister of Immigration has stated that when the borders open up not as many working visas will be issued as in recent years.

Heading into the GFC 4% of jobs in NZ were held by people on such visas. Heading into Covid-19 this was 8%.

This inflow of people has suppressed wages and taken pressure off businesses to boost productivity and train up people they might need.

Accommodation

There are shortages of housing in some parts of New Zealand which are pushing rents up and discouraging people from moving to locations of greatest labour demand. These shortages will eventually disappear. But for now, they make workforce planning difficult for firms.

Public transport

Lack of adequate public transport forces people to keep trying to live near their workplace, squeezing house prices and rental accommodation.

Bank finance

As our economy recovers from Covid-19 banks will become more willing to lend to SMEs. But that lending willingness probably won't go back to where it used to be. The world we live in is far more volatile than previously believed and banks will have to factor this change into their assessment of the ability of businesses as well as householders to service any given level of debt.

On top of this, fairly soon the Reserve Bank will put back on track the requirement for banks to raise their capital levels as protection against future shocks.

Businesses need to give greater thought to financing expansion through retained earnings and bringing in new capital than has traditionally been the case in New Zealand.

What to do

Before you commit to higher output, make sure you will be able to command the resources you need to produce that output. You'll have to engage in workforce planning in ways you have not done before.

You'll need to talk with your financier at the start of any expansion process rather than partway through it. You'll need to get deep insight into whether the infrastructure provided by your local authority can handle what you want to do.

You'll also need to pay a lot more attention to where you make your highest profit and which areas yield losses or minimal returns. This can mean stratifying everything by the following.

- Product
- Customer
- Outlet location
- Production location
- Production method
- Distribution method
- Supplier reliability

Be prepared to make some hard decisions including setting "free" some long-lasting clients who actually yield little if any return. And be prepared for the possibility that the route toward higher profit might not come from higher output, but from less.

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New Zealand's Housing Markets

Rent rises

I've noticed a few people this past fortnight claiming that average rents will not rise following the March 23 policy announcements because rents are set by incomes and as those household incomes are not jumping up rents will not jump either. This is not correct.

Data from MBIE tell us that since Labour were elected in September 2017 average rents throughout New Zealand have risen by 24%. In contrast, average incomes have risen by about 11%.

The rise in rents we can largely put down to the government increasing the costs of providing rental accommodation. And as regards ability of people to pay, that is what the Accommodation Supplement provides to hundreds of thousands of people. Their higher rents end up being covered in many cases by the taxpayer.

Speaking of taxes.

High-taxing government at work again

By boosting its tax take from landlords through removing ability to deduct their biggest expense, the government is taking advantage of the structural shift in the housing market towards reduced owner occupancy.

If someone lives in a house which they own the government receives no tax. But if they live as tenants the government will receive tax from the landlord. Therefore, the long-term transition in New Zealand towards a reduced owner occupancy rate has boosted government coffers and they've decided to boost those coffers again.

If the home ownership rate does not rise as a result of the change in interest expense deductibility, the net effect will be the same as introduction of a 39% tax rate – more revenue to the government.

Auckland data

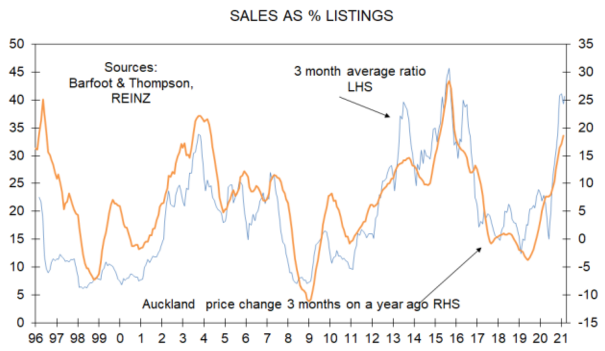
Barfoot and Thompson this week released their sales data for March. Their sales in Auckland last month were the highest ever and ahead by 68% from a year ago when we were on the cusp of having monthly data thrown all over the place by the nationwide lockdown. So, very soon you'll want to be very careful when looking at annual comparisons of data because in most cases the changes will be meaningless.

It will be better to look at the up to date seasonally adjusted change estimates and doing so for these numbers we can see evidence of about a 12% fall in their sales in March compared with February which was up by about 8%.

Their average sales price measure was ahead 12% from a year earlier at just over $1.1mn from $1.08mn in February.

The main reason I examine the Barfoot and Thompson data is because it allows me to present this following graph. It shows as the blue line the three-month average ratio of sales to their listings. The orange line shows the annual rate of change in Auckland house prices as measured by the REINZ House Price Index.

There is a tendency for changes in the ratio of sales to listings to lead changes in house price inflation and the ratio indicates further price appreciation may lie ahead, but things are topping out.



Personally, I have no trouble believing that over the next few months we will see some months where average price measures decline slightly. This will largely reflect the absence of an investor buying binge to beat the 40% minimum deposit requirement, plus some pulling back of investor buying following the March 23 announcements.

A key area of uncertainty regarding short-term price movements is not so much how many investors step forward to sell and how fewer might buy, but how many existing vendors capitulate in their price expectations.

That is, many vendors have been seeing extremely high prices being gained by other sellers and have been holding off to get their own high price. At some stage this behaviour will change and there was just the slightest hint of it in the REINZ & Tony Alexander Real Estate Survey discussed above.

Frankly, these are extremely early days in the adjustment of residential real estate markets around New Zealand to a whole range of factors, and one would be quite silly to make any strong statement regarding what prices will do in the near future.

We don't really know how big the dummy-spitting factor is behind the reactions of investors to the March 23 changes. We don't know when vendors capitulate on price. We don't know if first home buyers will dive into the market anew in the near future as they did after last year's Covid-19 shock.

If you're purchasing for the long-term then maybe it doesn't matter.

Links to publications

[Tony's View Spending Plans Survey]

[Tony's View 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]