TONY'S VIEW

Input to your Strategy for Adapting to Challenges

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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.

V-Days

I have a theory regarding what we are going to focus on in coming months, and you can form your own view on what that might imply for our behaviour.

When the first lockdown came along it was a shock, we all made literally millions of predictions about what the impact would be, and many have turned out to be wrong. We did things like jumping into asset markets – shares and property – reacting to low interest rates, cash building up, and travel money not being spent. We obeyed our leaders and probably felt high pride when we emerged after seven weeks and quickly went to Level 1 Alert.

This time around I have detected not an air of shock, but of disappointment, a bit of anger, and a desire to just get the damn thing over and done with. We are so over Covid-19 and want our normal lives back. And that is where my theory comes from.

It seems probable that once we get a solid report that stage three trials for one of the vaccines under testing have proved successful, we will immediately place pressure on the government to tell us when we can expect vaccination to start in New Zealand.

There will be lots of ifs and buts and maybes, but after a few days or weeks we'll settle on an expectation that the rollout will start in X month next year. Perhaps in our own way we will offer our ideas or resources for how we can help make the rollout as smooth as possible. A period of national mobilisation.

Then, as soon as we have settled on an official or assumed date for our vaccination rollout, we will form an opinion on when much of the rest of the (developed) world will be vaccinated. And we will then speculate and settle on a month when we expect our borders to be open again. And that is the date we will start working toward as we contemplate our business capital spending, hiring, our consumer spending and so on.

Maybe when the vaccination starts in New Zealand, we will call it Vac-Day and maybe it could make for a useful national holiday in the future.

And when the borders open and volumes of visitors can start flowing back in, we might call that Vis-Day – vaccination and visitors, vac and vis.

As we focus on these positive events and the economic stimulus we expect them to bring, we may blatantly look through whatever negative economic data get released or new negative developments occur, just as we have already done for this morning's GDP release. We will ignore things which in normal times have generated worries about things like household spending, unemployment, house prices etc. We'll simply say, yes, but when vac and vis come we're taking off again so this doesn't really matter.

In economics, in financial markets, it is expectations which matter. Those expectations will come into play and they will drive our current decisions regarding willingness to bid for a house (before the hordes arrive from overseas), willingness to snap up a cheap tourism operation or Airbnb place, willingness to retain staff and hire new people.

For these reasons 2021 could be a year of reasonably good economic growth driven not by the detritus people will see around their feet as we still suffer closed borders, but the better times to come from vac and vis.

Their fair share?

Labour has couched its promise to place a 39% tax rate on all personal income above $180,000 in terms of upper income people making their fair contribution toward reducing government debt. They do not mention that these people already pay probably over 20% of the total income tax take even though they make up just 2% of the adult population.

The best data showing this come from Treasury's May Budget documents and can be found at this url.

https://treasury.govt.nz/information-and-services/financial-management-and-advice/revenue-expenditure/revenue-effects-tax-changes/who-pays-income-tax

The site contains the table below showing that in the tax year 2019/20 which ended in March, the following proportions of the $37bn income tax take were paid by the country's 3.9 million adults in the various income brackets. Basically, 24% of income tax is already paid by the 3% of people earning above $150,000 a year. These "rich pricks", as the last Labour Finance Minister called them upon entering Parliament, are already paying their fair share toward government redistribution of income and services to others in the country.

Income to $	000s	% population	% tax
0	218	6	0
10,000	374	10	0
20,000	644	17	3
30,000	588	15	5
40,000	342	9	5
50,000	337	9	6
60,000	311	8	8
70,000	246	6	8
80,000	190	5	8
90,000	154	4	8
100,000	105	3	6
125,000	145	4	11
150,000	74	2	7
>150,000	122	3	24
	3850	100	99

Labour's 39% tax rate proposal cannot be justified on either the grounds of making higher income earners pay their fair share, or that the need exists to get debt down starting from next year. The move is driven by ideology, just as policy proposals from other parties also are. Speaking of which, National's policy of cutting debt to 30% of GDP within ten years is pointless in a world where not a single credit rating agency or investor is demanding it.

And, just to keep spreading the love, NZ First's policy of keeping the Bluff smelter open whatever the cost is the sort of thinking which got our country into the Muldoonist mess of the 1980s. The Green's policy of bringing in a wealth tax is socialism leading eventually to "the workers control the means of production" to quote Monty Python quoting Marx.

Economic Shrinkage

Purely for the record because the data are well out of date and massively covered elsewhere – this morning Statistics New Zealand reported that our economy shrank by 12.2% during the June quarter after shrinking 1.4% in the March quarter. Clearly the decline was a one-off associated with the seven weeks of lockdown, and when third quarter data are released in three months a substantial bounceback will be recorded. The NZ decline was worse than many other countries because of our high exposure to international tourism. Which means what? When borders open up again, we will receive a greater growth boost than many other countries.

TONY'S VIEW

New Zealand's Housing Markets

25 Reasons Why House Prices Are Rising – and Counting

Treasury warn that house prices might fall 7% from their current levels. But chances are they are much too pessimistic and the recent rise in prices will continue, though at a slightly slower pace because there will be some bounce-back effect in price gains these past three months. Average NZ house prices now sit 1.5% above levels in March.

Here are 25 reasons why house prices have surprised us with their strength. Many (not all) of these factors will continue to apply over the coming year and beyond.

1. Interest rates

The Reserve Bank cut the official cash rate 0.75% in March and since then floating mortgage rates have fallen to near 4.5% from 5.3%. The two-year fixed rate has fallen to 2.65% from 3.55%. Term deposit rates have also fallen, with the six-month rate going to 1.3% from 2.3%.

Lower interest rates have made purchasing a home more affordable, and encouraged investors seeking higher yield than now offered in bank term deposits to look at other assets including property.

2. Interest rate expectations

It is not just that interest rates are low. The Reserve Bank have made it clear that they intend to keep rates low for many years, with assistance from the US Federal Reserve which has just shifted their policy stance toward multiple years of low rates to try and generate inflation above 2% for a number of years. Also, our central bank has indicated it may introduce a negative official cash rate next year.

Expectations that interest rates will stay low are encouraging people to expect that other people in the future will be seeking higher yielding assets including property. So, they are buying before this expected extra demand comes along.

3. Migration boom

Even before we had heard of Covid-19, from the middle of last year a change was occurring in the net flow of Kiwis across our borders from negative to positive 2,800 come the end of 2019. By March this year the net Kiwi flow was +13,000, contributing to a record net inflow for all countries of 90,000 from 50,000 a year earlier.

We already have in the country the net migration gain we expected would be recorded by just after the middle of 2021. This means extra pressure on rental accommodation, allowing investors to (now) raise rents, whilst discouraging them from selling and encouraging more purchasing.

4. Migration expectations

Most Kiwis expect that when the borders reopen, we will see a great number of our expats coming home – along with many foreigners wanting to shift here. Expectations of a coming horde which will purchase property is encouraging extra purchasing now – especially with people swapping stories of expats buying property unseen whilst still offshore. The numbers doing so are however probably very low.

5. Migration Data

And third in the migration spot, it is entirely possible that despite our borders being closed, in a few months our monthly net migration numbers will be back above 1,000. Why? Because the chances are high that inflows into NZ through quarantine will stay firm (though easing) ahead of the borders one day reopening. But outflows will peter off as the government makes it easier for visa holders to remain here, and long-term foreign visitors will have already departed.

This possible yet-to-arrive factor will add to expectations of a return to high annual net migration inflows when the borders open.

6. LVR Removal

In March the Reserve Bank announced that it was removing Loan to Value Ratio requirements. First home buyers have read this to mean that banks will accept much smaller deposits, and they have entered the housing market in high numbers.

7. Cash Build-ups

During seven weeks of lockdown, young people built up cash savings through wage income continuing, but spending on bars, clothes etc. no longer being possible. They also now have spare cash which had been allocated for overseas travel. For some this will have encouraged efforts to build a deposit now rather than later, and in seeing their deposit grow they have entered the housing market.

8. Travel and Housing Switch

Unable to travel, but still wanting to, it is likely that some young people have decided to switch their planned spending timing between travel and housing. They have changed from planning to travel then look to buy a house, toward buying a house first, then later on travelling.

9. Expected Reduced Construction

Although monthly dwelling consents have yet to trend downward, the expectation of most people is that the Covid-19 shock and tightening of bank lending criteria will lead to a reduction in house construction over the next couple of years. Reduced supply will tend to place upward pressure on prices unless demand also declines.

10. Unemployment of Non-home Owners

The bulk (not all) of the people losing employment as a result of the Covid-19 shock are in the retail, hospitality, tourism, entertainment, and accommodation sectors. They tend to be young, earning below average wages, and not home owners. The Household Labour Force Survey says 90% are females, but I have found the below-headline numbers in the HLFS to be quite volatile in the past, with changes that don't seem to line up with reality. So, chances are, it is not true that 90% of the job loss burden is being borne by females.

Unlike previous recessions, we are not seeing many distressed sellers in the property market.

11. A Focus on Home

Around the world people have turned their attention to their immediate living arrangements. This has produced a boom for the home renovation sector. Focussing on improving one's nest is easier if one owns the property and can change it around at will, as compared with renting. Therefore, the Covid-19 shock has probably produced a desire to shift from renting to owning.

12. Listings Shortage

We went into the Covid-19 shock in March with the stock of property listings around New Zealand down 27% from March 2019 and 64% from March 2010. At the end of August, listings were still 13% down from a year earlier. By comparison, in March 2019 listings were ahead 3% from March 2018. So, we entered the shock with a rapidly growing shortage of listings.

13. Hidden Buyers

It is likely that over the past four years a high number of people wanting to buy a property had given up in the face of rising prices and insufficient listings. Seeing the Covid-19 shock come along, some of these buyers not active in the market are likely to have become incentivised to re-engage amidst hopes of distress bringing many new vendors to the market.

14. Fear of Not Being Able to Repurchase

There is now so much awareness of a shortage of stock that agents are reporting vendors as being unwilling to sell because they do not want to run the risk of bit being unable to quickly purchase a new suitable property. The listings shortage has started to feed on itself in a self-perpetuating manner.

15. Fear of Missing Out

This is known as FOMO. It has been around forever, but in past periods of strong house price growth in New Zealand is not a term which has been in common usage. It means, in the current context, people have become concerned that if they do not make a purchase now, they will miss out on a likely capital gain or on the opportunity to buy something at all.

This fear of missing out is encouraging people to make a purchase as early as possible – dragging future purchasers into the market now, before their intended purchase timing of perhaps next year or 2022.

16. High Household Wealth

It is not true that Kiwi households are poor, even though the common message is that we are. We are meant to believe that we all live with high levels of debt which will one day cripple us, house prices, and our country's future.

In truth, household debt amounts to some $300bn. But household housing assets amount to near $900bn, and financial assets like shares, managed funds, company ownership, bank deposits etc., amount to $1 trillion. Net worth is around $1.6tn. Some 43% of owner occupiers do not have a mortgage.

Not everyone passively manages their net worth. Sensing a need to gain a decent return and perhaps an opportunity in the housing market, plenty of people are able to become property investors.

17. Giving up on Travel Dreams

Many people have assumed international travel may not be possible for a number of years. Some of these people have decided to purchase a second property to use for holiday purposes in New Zealand, and this probably helps explain the limited decline which has occurred in Queenstown Lakes District property prices (down only 1.9% in the three months to August from a year earlier, versus a nationwide rise of 1.3%, and Dunedin City fall of 3.1%).

18. Money Printing

This is something new for New Zealand. Overseas experience shows that central bank buying of bonds and conversion of bond investors' bond asset into a bank cash deposit places upward pressure on asset prices including shares and property. The Reserve Bank admitted in May that there is a risk their bond buying pushes up asset prices, and it is now commonly discussed that their actions are contributing to higher house prices – often in the context of a debate about their contribution to a widening of the wealth gap in our country.

Growing awareness of the impact of the RB's actions is likely to be contributing to a desire by people to buy before the RB causes prices to rise further.

19. Mortgage Deferrals

The introduction of this scheme and its extension to March next year will have taken away the immediate pressure on many people to sell their house through inability to meet mortgage payments. The scheme has reduced current seller numbers.

20. Good Financials Leading into the Covid-19 Shock

Household debt in the five years leading into this shock grew near 40% compared with 80% in the five years ahead of the 2008-09 Global Financial Crisis. More than that, the introduction of LVRs in 2013, plus the application by banks of high test interest rates for assessing debt servicing capacity of borrowers, meant there was little high-risk housing debt heading into the shock. This has limited mortgage stress – as these measures were designed to do.

21. Lack of Bank Staff

Banks have not had the staffing resources to handle many mortgagee sales, with personnel run off their feet adjusting to working from home and processing credit assistance applications from businesses and home owners.

22. Soaring Share Prices

Share prices rose very sharply from late-March and this may have encouraged a positive view by investors of other, less rapidly repriced assets – like property.

23. Job Losses for Migrants

Just as many job losses are hitting young people who do not own homes, they are also hitting the many migrants on working visas who were present in the accommodation and hospitality sectors in particular. Heading into this downturn 8% of jobs in New Zealand were held by migrants, compared with 4% at the start of the GFC.

To the extent migrants bear much of the burden of unemployment, this does not produce a hike in the number of distressed property sellers, because they will not be property owners.

24. Quiet Government

A key point I made many months ago was that calls by large bodies for house prices to decline in the interests of social equity would disappear. I noted that neither the Reserve Bank, banks, Treasury, or Government would want house prices to be falling this year. Falling prices would make the economic downturn worse.

It has come to pass that we rarely read of desires these days for house prices to fall, and lack of such expressions from senior government members in particular has removed one factor which might have stayed the hand of many potential property purchasers, whilst also potentially encouraging some sellers. Policy makers want house prices to rise.

25. Wage subsidies

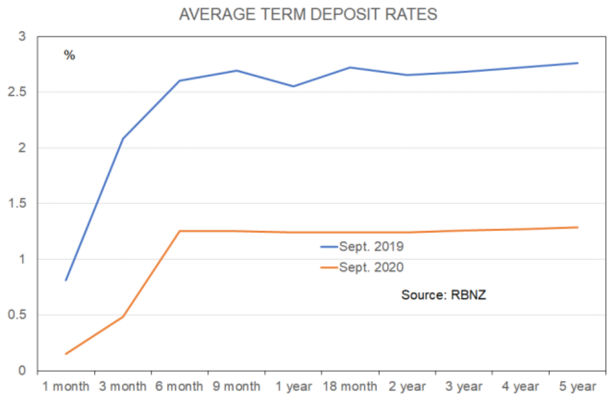
Were it not for the three rounds of wage subsidies to employers to keep staff on there would be a lot more people unemployed currently. The absence of this unique employment shock has reduced the number of property sellers and kept many potential buyers engaged with the market.

Interest Rates

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

It should come as no surprise to anyone that over the past week bank term deposit rates have continued their downward trek. Average 90-day rate falling to 0.48% from 0.53% last week and 0.62% four weeks ago. This rate six months ago was 1.8%.

The five-year average term deposit rate has fallen this week to 1.28% from 1.35% last week, 1.52% four weeks ago, and 2.5% six months back.



Given that banks are facing falling lending volumes to the business sector and high deposits, they are under no pressure to offer attractive term deposit rates in order to boost funding levels. Therefore, depositors should expect that rates will continue to edge slowly lower.

With regard to wholesale interest rates this week – nothing interesting happened. Sure, there were the new forecasts from Treasury to peruse. But they generally were in line with analysts' expectations apart from a slight reduction in this year's planned government bond sales.

Treasury have penned in a 0.1% 90-day bank bill yield all the way out to 2024 and it is hard to argue against that track being a high possibility. They have not allowed for the cash rate turning negative next year but will simply adjust their forecast track like the rest of us if that does happen.

This morning's June quarter economic growth numbers also had essentially no impact.

Regarding mortgage interest rates – no changes were made by the lenders I track. But chances remain good that in the next few months the 1-2-year rates will be cut slightly. For terms longer than that rate cuts are less probable given where margins are sitting.

If I were borrowing currently, personally speaking, I'd fix five years. That is not because I necessarily think I will face a lower cost that rolling at one or two-year terms. It's more a sleep easy in life and focus instead of adjusting to our Covid world. That for me would be a higher priority made relatively easy to focus on by the fact that mortgage rates are at record lows and nowhere near the 18.5% I paid for my first mortgage back in 1987.

But for most people, fixing one or two years is probably optimal – from a cost minimisation point of view – you know, the same thinking which underpins acceptance of the lowest cost tenders for building our motorways and running our bus services. That never goes wrong does it?

My daughter Lilia Alexander (finalist in the Youth category for Wellingtonian of the Year 2019) owns and runs Social Media based Wellington – LIVE (>200,000 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
She also now has a photography site. https://www.liliaalexander.com/photography

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

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