# 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.

## Our 2021 Economy

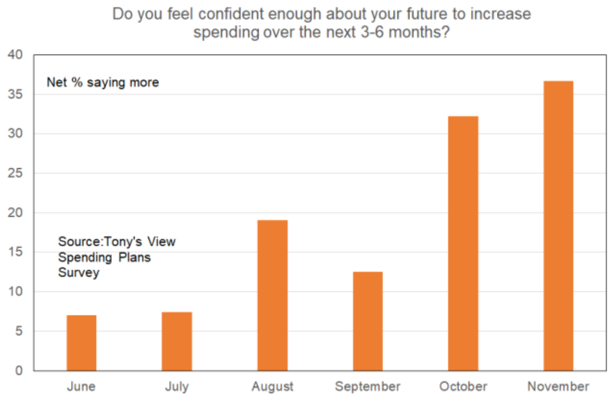
### Forward looking measures of where our economy is headed point toward good growth.

I've delivered quite a few presentations to clients over the past couple of weeks and in some of them I've been running through a list of indicators turning in the right direction. In no particular order of importance here are a few of them. Note that all of the indicators are forward-looking. I have not looked at actual statistical data on how much spending you and I have been doing.

**Tony's View Spending Plans Survey**

- This month a net 37% of respondents plan spending more in the next few months, up from a net 32% in October and 13% in September.
- A net 18% of people say they are seeing their wealth rise versus 15% last month and just a net 2% in June.
- A net 4% of people expect their business profits to go up, from 3% last month and -13% in June.

These various indicators tell us that it is reasonable for retailers to expect good sales heading into Christmas, and that there are more than just low interest rates underpinning this positive outlook. People are feeling more secure in their jobs, and business owners are becoming more optimistic about their returns.




**ANZ Business Outlook Survey**

- A net 5% of businesses in October said they expect their activity levels to rise over the next 12 months. This was below the 23% average, but up from the -55% low and -5% in September. The trend is firmly upward.
- A net 3% say they will still lay people off which is below the average +9% saying they will hire more staff. But the low was -51% in April and September was -12%, so again the trend is firmly up.
- A net 2% of firms say they are going to lift capex, up from the -45% low and approaching the 9% average.

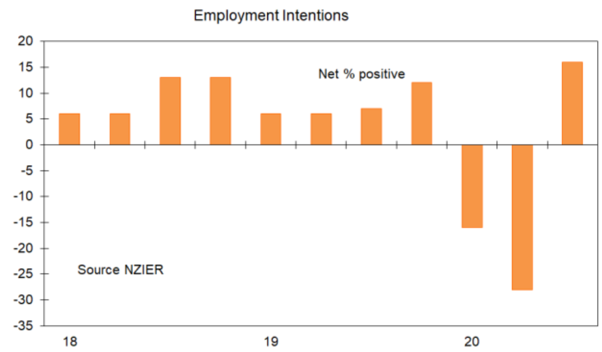
These results were little changed in the preliminary numbers for November which were released last Thursday. They are important because of their upward direction of movement more than their actual levels.

## NZIER Quarterly Survey of Business Opinion

- A net 16% plan hiring more people, above the 13% average and up from -28% in the June quarter.

There are plenty of positive labour market indicators and anecdotes one could cite. But this above-average level of hiring intentions probably best sums things up. Businesses are seeing good activity levels, experiencing some firm trading conditions, and realise they need to both keep people they have and look to hire more people.

This again is a key factor which goes towards underpinning consumer willingness to purchase goods and services.




## ANZ Commodity Price Index

In world price terms this index has strengthened by 3.6% in the past six months and analysts are revising up their forecasts for the dairy payouts this season.

The world outlook remains fraught. But demand for our mainly food exports is good and with 55% of our exports going to Asia, the improving conditions there suggest a good underpinning on our regional economies going forward. This is not the same thing as saying farming will lead our economy upward over 2021. It won't. It is simply saying that the primary sector has some solid footings which will contribute to growth in the economy and offer work opportunities for many Kiwis – which they probably won't take up.

The improving feeling of job security will tend to keep unemployed people in the cities rather than encourage them to seek jobs in the farm-servicing regions.

## House Construction

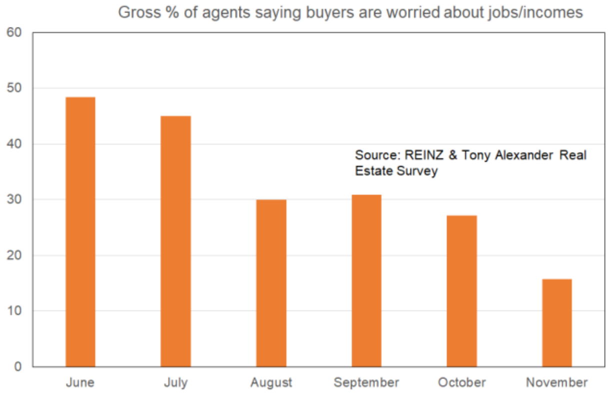
- A net 14% of firms in the ANZ's monthly survey now expect higher levels of house building, up from -64% in April though still below the +28% average.
- The number of dwelling consents issued rose a seasonally adjusted 7.4% over the September quarter.
- Builders are reporting shortages of labour once again.

The outlook for house construction has changed dramatically over the past few months – from a big fall toward solid growth in demand. Property buyers cannot find something to buy on real estate websites. So, they are going to builders to get something new erected instead. This is leading to sections and developable land being soaked up quickly around the country.

House building has a large multiplier impact with business generated for civil engineering firms, manufacturers of building materials, transport and machinery companies, councils, architects and so on.

### REINZ & Tony Alexander Real Estate Survey

- Only a net 16% of agents now say that buyers have worries about their employment. This was 48% in June. Job security is rising.



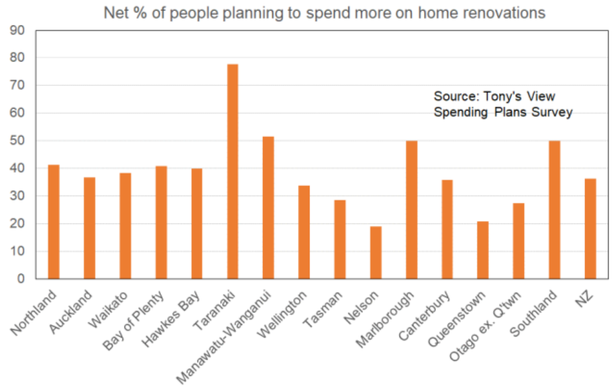

This backs up other measures showing a firming labour market and calls into question the forecasts of further deep deterioration in our labour market still being made by some analysts. Some of those analysts are the same ones who predicted house prices would fall by more than 15% (they fell 3%), that the economy would shrink over 20% in the first half of the year (it fell about 13.5%), and that the unemployment rate would be above 11% in the September quarter. It was 5.3%.

Be careful who you are paying attention to. The prediction records of some through this period have been quite bad and have revealed a headline-grabbing negative bias which they still can't shake off and perhaps don't want to.

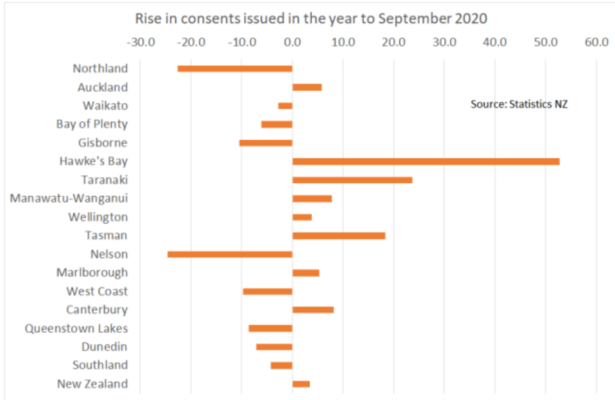
## Regional Home Renovation Outlook

I gave a presentation last week to a conference of people involved in the installation of kitchens and noted that I'd include some information here which would give some insight into regional demand trends. So here it is.

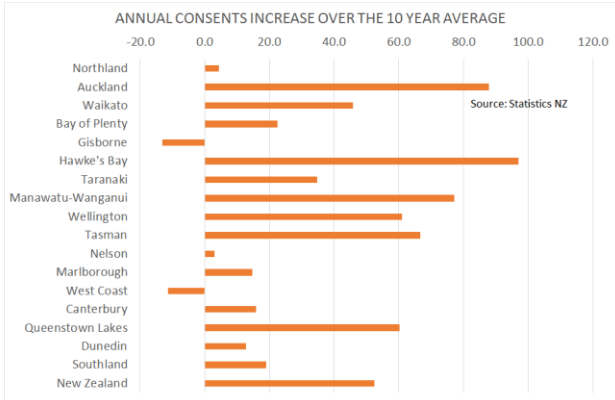
First, here are numbers by region from my Spending Plans Survey regarding intentions to spend on home renovations. Taranaki is strongest, Nelson and Queenstown relatively weak.




We can also look at growth in the number of consents for new dwellings to be issued. This first graph shows growth during the past year. There is very strong growth in Hawkes Bay, Taranaki, and Tasman.




We can also compare consent numbers issued by region for the past year with the average number for that region over the past decade. There is high activity in most locations excepting Gisborne and the West Coast and Nelson.



# TONY'S VIEW

# New Zealand's Housing Markets

## Factors Driving House Prices Higher

In my weekly publications of September 17, I published a list of 25 reasons why house prices are rising so strongly. Just in case you're forgotten, here are most of those factors; less than 25 this time as I've rolled a few fleshed out back then into one.

- Interest rates at record low levels and expected to stay low for many years.
- A record net migration boom pre-lockdown and widespread expectations of a new boom once the borders reopen.
- Removal of Loan to Value Ratio regulations (LVRs).
- Cash built up during seven weeks locked down.
- $10bn not able to be spent on foreign travel being reallocated to general spending and housing.
- Job losses concentrated amongst young people on below average wages who do not own houses – hence few unwilling sellers.
- A new focus on one's home nest because of the lockdown plus inability to travel.
- A structural shortage of listings.
- The queue of pent-up demand or frustrated buyers being far greater than any of us thought.
- Fear of missing out – FOMO – raging in increasing strength.
- Fear in particular of not being able to buy if one sells contributing to a shortage of listings.
- High net household wealth for Kiwis of $1.7bn. Not everyone is poor in or country.
- Good financials for the country, banks, and most people leading into Covid-19.

Yes, the mortgage deferral scheme and wage subsidies have helped. But their contribution to this current boom pales into insignificance besides the factors above.

Just in case you're new to my stuff, this link will take you to my 2012 list of 19 reasons why Auckland house prices would rise strongly. Page 5.

https://ndhadeliver.natlib.govt.nz/delivery/DeliveryManagerServlet?dps_pid=IE14565667

Perhaps a new factor I could add to the current list is the scramble for developable land and sections. It is clear that any period of weakness in house construction associated with this virus shock will be minimal. Frustrated property buyers are turning to builders to get new houses constructed and this is leading to aggressive bidding for land able to house townhouses in particular in Auckland. But it is also leading to land being snapped up around the country.

This is important. House building has a substantially positive multiplier effect on the overall economy. One of the key driving forces behind good growth in our economy over the next few years is going to be residential construction. Banks will eventually become assured enough about the future for the economy that they will increase lending to developers.

But that might take some time. That opens up increased opportunities for capital to move into the residential construction sector to start financing construction. In an environment of sustained low interest rates, vehicles offering people an opportunity to gain exposure to a sector on a long-term upward path offering some extra return, are likely to be in high demand.

## LVRs to return

Yesterday, the Reserve Bank responded to evidence about the shifting housing market and said they will initiate discussions with banks with a view toward reintroducing LVRs from March 1.

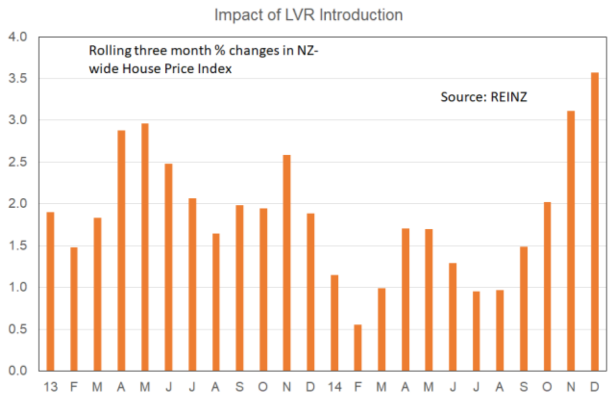
There's a lesson about monetary policy I recall from a long time back. It works best when a change comes as a shock. The RB should have reinstated the investor LVRs from next week or at the latest December 1. Why? Because they've just sent a signal to buyers that if they want to get maximum bang for their deposit buck, they need to buy something before March 1, and probably before the start of February.

By effectively setting a timeline for the inevitable return of LVRs the Reserve Bank will ignite greater strength this summer in the housing market. The next two and a half months could be a buying frenzy.

But what will happen when LVRs return? Let's have a look at what happened when they first appeared.

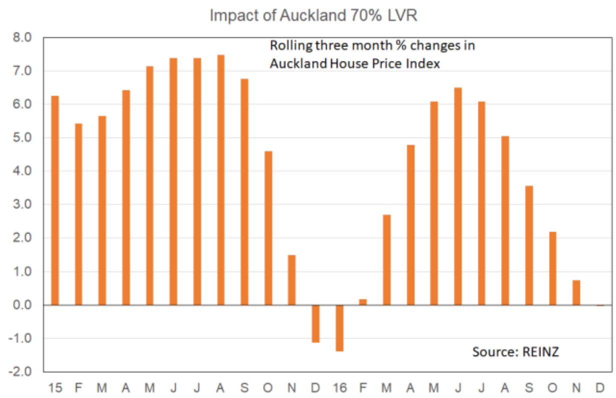
LVRs were first made effective from October 2013 at a rate of 80%, meaning a minimum deposit of 20% for all but 10% of residential mortgage lending. Ahead of that month average house prices were rising on average about 2% every three months, or at about an 8% annual rate. This dipped to 0.6% by February but then recovered above 1.6% by April.

One could reasonably say that house price rises stalled for about three months then returned – clearly with a vengeance barely a year later.

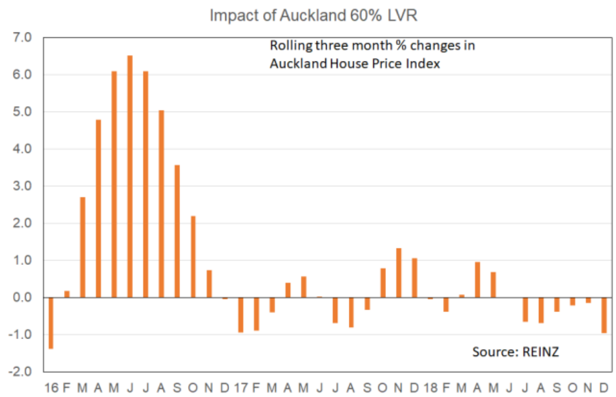



So, the Reserve Bank introduced a 30% minimum deposit requirement for Auckland investment property purchases from October 2015. What impact did this have in Auckland?

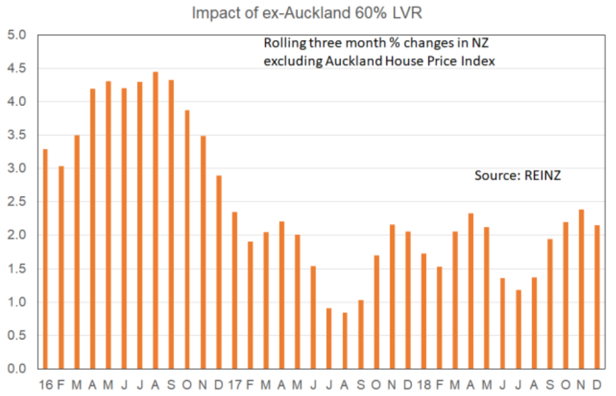
The three-month rolling rate of increase in Auckland's average house prices slowed from around 6.7% to a small decline, then was back at 6% seven months later. Again, the impact was only temporary. Note this second graph starts in January 2015 whereas the one above started in January 2013.




The next change was an even 40% minimum deposit requirement applied to all the country's investors officially from October 2016, but in practice by banks from July 2016. What impact did this change have? The move crushed the life out of Auckland's market – but it was due for a rest anyway. The following graph starts in January 2016 as does the one after it for NZ excluding Auckland.




Outside of Auckland the 40% deposit requirement for investors from July 2016 had a slowing impact as well, but price growth settled at a rate well above that for Auckland as the regions underwent their catch-up phase.




What this suggests is the following. NZ-wide house prices have risen by 4% over the past three months. There will be an upward bias to this growth caused by the falls over April and May. But with a net 88% of real estate agents responding around the country in the survey I run with REINZ saying that they are seeing FOMO, the case is made for at least a 30% minimum deposit requirement. But 40%? Probably not given the Reserve Bank's desire to leave monetary conditions overall at very loose settings in order to facilitate firm economic growth.

But will rapid house prices rises contribute to growth? More than you might think. Not via a wealth effect but by the switching of buyers toward getting a house built which is driving what will be an extended boom in residential construction around New Zealand. Thus, I do not believe that the Reserve Bank wants to stop house prices from rising.

## If I were a borrower what would I do?

### Me? I'd still fix five years. You? Be careful of grabbing the candy.

Regular readers will know that I am a fan of fixing five years at 2.99% rather than grabbing the one-year candy at 2.49%. Why would I be willing to pay 0.5% more on a mortgage (if I had one)? Simple, and to repeat something I have been pointing out for the past eight years.

No-one on the planet since 2007 has anything approaching a good record of forecasting interest rates. We all missed the big declines of 2008-09 because we couldn't see the GFC coming. Then we found our economic models have not adequately predicted how inflation would react to firm economic growth in a world of de-unionisation, offshoring, excess capacity and search engines removing pricing power for most businesses.

Our proclivity since 2010 has been to generate interest rate predictions which are too high. At some point that will change and at a minimum our forecasting uselessness will become balanced.

I am of the view that in the most uncertain economic period any of us have lived through, getting some certainty regarding debt-servicing costs is a good idea. It can allow one to focus on other issues including restructuring for the many changes I have discussed this past decade as well as Covid-19.

Do I know when long-term fixed rates will rise to reflect things like the Vac and Vis days I wrote about in September? (Vac = Vaccination Day when we start to get a jab, Vis = Visitors Day when the foreign tourists start flocking back here again and boosting our growth.) No. But at some point, yield curves will steepen. Markets will pull back from expecting monetary policy to be as aggressively loose as it is at the moment, and economic growth outcomes will surprise on the positive side.

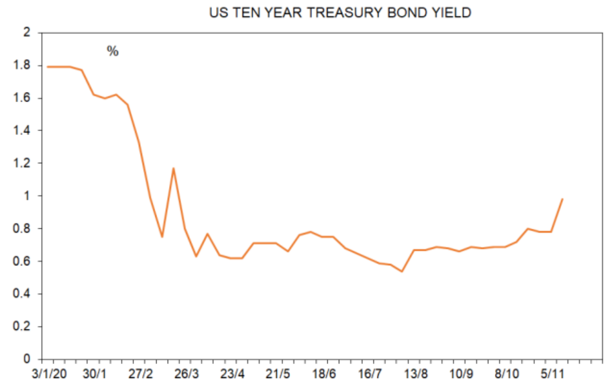
We already have that second element in place in New Zealand with most of the pieces of economic data and commentary you are reading now revealing the situation for our economy to be a lot better than was expected some months ago.

These surprises encompass the following.

- Retail spending
- Domestic travel
- Tax receipts
- House sales
- House prices
- House construction
- Demand for industrial and storage property
- Dairy payouts
- Export receipts
- Job numbers and labour availability
- Unemployment numbers
- Migration flows pre-lockdown
- Business sentiment, hiring, and capex plans

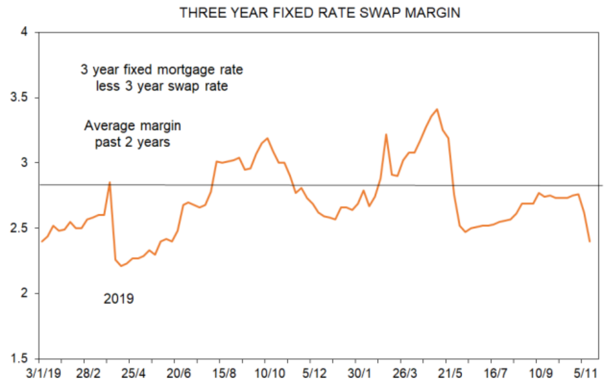
The chances are not high that the Reserve Bank will take the official cash rate below 0% next year – something I have seen as unnecessary since the day they mentioned it. Markets are now starting to slowly price away the chance of a negative rate and we are seeing some rises in medium to long-term swap rates, accompanying increases in rates offshore.

The United States ten-year government bond yield for instance has risen from 0.67% three months ago to 0.98% now, lifted largely by Pfizer's vaccine news.




The NZ three-year swap rate has risen this week to near 0.25% from 0.03% last week. The five-year rate has risen to near 0.37% from 0.11% - the highest rate since the middle of July.

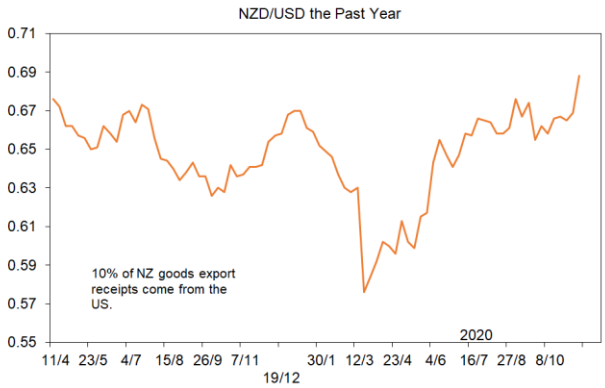
In Tview Premium I include graphs showing the margins on fixed rate lending. Because I feel this current issue and the way that things are turning is important, I'm going to print the three-year one here.

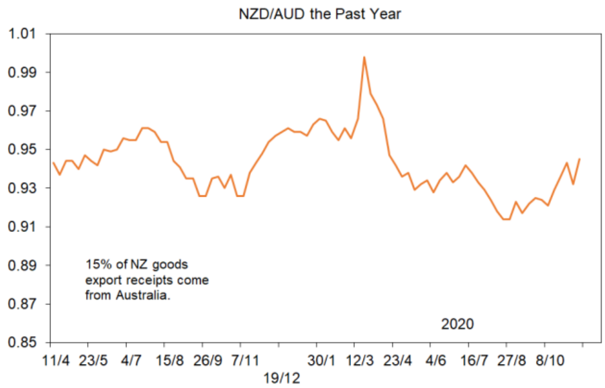



Margins for longer terms have moved firmly below average and are approaching about as far as they tend to get away from those averages. Which leads me to say this. If we get much further upward movement in swap rates, we will soon see banks raising their three years and beyond fixed lending rates. You've been warned.

## NZ Dollar

Just briefly because I have the space left on this page, the NZD has climbed further this week supported by a rise in global investor risk tolerance stemming from the Pfizer vaccine news. Also, markets here are pricing way the chances of a negative official cash rate next year and that in particular has lifted the NZD against the AUD above 94 cents.

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