TONY'S VIEW

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 23 April 2020
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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.

Mistaken Thinking

We are in recession, and in recessions there are certain things which happen. Obviously, some people lose their jobs, some businesses close down. People also feel worried about their future, and they feel that whatever the future holds it won't be like the past. The shock is invariably seen as so disturbing that the world will change in big ways. And people spend months giving their opinions about how the world will change.

We are desperate for insight into where things are heading, and because we are confused about what is happening around us, we tend to give greater credence to views than they might deserve. Too often someone delivering a view is focussing very strongly on one particular thing and failing to take into account other things going on. Sometimes the person giving the opinion has always had that view and is pushing the same issue in an opportunistic manner.

So, let's consider a few of the things which people are talking about which, because you are confused, you might be giving too much credence to.

Firstly, some people are saying that because factories in some other countries have been closed for a while, and because shipping routes have been interrupted, it is dangerous to rely on businesses offshore to supply what we need. We should make more of what we consume ourselves.

We consumers tend to buy whichever good meets our needs at the lowest price. Companies source the inputs they need also at the lowest price by and large. To varying degrees, we take product quality into account. Most of the things you and I buy can be produced a lot more cheaply overseas than here in New Zealand. That goes for almost all our electronics, vehicles, and so on.

We are not going to see a structural lift in the size of the NZ manufacturing sector as a result of a once in a century pandemic event. In fact, chances are it will shrink because that is what happened after the GFC. History tells us that when manufacturers close down, it is rare for new ones to pop up and replace them. This is especially the case in regional locations.

Second, a popular view is that farming will lead us out of recession. By definition, the absence of our previous biggest export – inbound tourism – means that farm exports are relatively more important. We are more dependent upon farm incomes, commodity prices, farming conditions, than we were before. These things can be volatile so underlying volatility in our economy in the next few years will be slightly higher than would otherwise be the case.

But just because farming is once again being correctly recognised as the backbone of our economy does not mean that the sector will lead us out of recovery.

You can't scale up farm production in a short period of time. You can't suddenly break in new farmland, it takes time for animals to be born and grown for meat and wool, same for dairy. Along with that, farming has become less labour intensive over recent decades and especially the past decade when attracting people into the farming sector has been very difficult. The trend in farming and horticulture is toward mechanisation and that is unlikely to be interrupted.

In addition, with a weakening of the world economy it is reasonable to expect that our commodity export prices will decline slightly over the coming year. That means that although farmers will have the benefits of reduced interest rates, a slightly lower NZ dollar, and improved labour availability, they're not going to enjoy an income boom which will see them spending up large domestically. They have lots of capital spending to do to meet environmental targets and that will keep spending levels in other areas in check for a number of years. Plus, banks will be reluctant to extend much more credit.

And what if other countries react to food security concerns by newly subsidising their own farmers?

Note also that during the GFC a popular view was that farming would lead us out. The sector has grown across many areas for sure. But our economy did not become more dependent on farm earnings after 2008.

Third, many people are doing their best to scare you with forecasts of how high the unemployment rate will go. The media did a superb job of this last week when commenting on Treasury's potential economic scenarios. They didn't highlight the most likely possibility. Instead they pointed out what the worst-case scenario.

The most likely Treasury scenario is of us being at Level 4 alert for four weeks then Lever 3 for four weeks, and after that Levels 1 and 2 for the next ten months. We have almost five weeks confirmed at Level 4, and there is a good chance we will have two weeks at Level 3. All up that looks slightly better than Treasury's main scenario, but let's call it the same.

Treasury also assume that there will be another $20bn worth of stimulus from the government. We have so far had just over $3.2b extra announced last week, and the May 14 Budget is certain to contain a lot more extra spending focussed on jobs creation in as short a period of time as possible. Remember, there is a general election in September.

Under this highly probable scenario Treasury see our unemployment rate peaking below 9% and starting next year just below 6% - back where it was in 2015.

That certainly means a lot of disruption for a lot of people, mainly in the service sector part of our economy surrounding tourism and hospitality. These sectors employ a lot of migrants on working visas, many of whom will have to leave. Their weakness will disproportionately affect young people.

But a key thing to note about these young people is that they know nothing other than a world of many job opportunities. Very few will have entered their position with a view that it will be their career for the next four decades. This is not the 1960s. They will have an openness to accepting work in other sectors and a flexibility of skill acquisition never before seen in our future. Plus, they are building resiliency. These people are going to be very employable. This is not the 1980s.

For most, their unemployment position will be short-lived. But it will still be a shock as they have never experienced a recession before. And this is not to minimise the pain which the business owners will feel – people often with their houses on the line. But it's a matter of scale.

And that brings me to the most important thing here which many people pushing their particular negative view have failed to acknowledge. The government is throwing everything they have at this crisis. They are not keeping things tight in order to get their deficit down, to get the current account deficit down, or get inflation down, or keep credit rating agencies happy, or restructure the economy. The current members of Parliament come from a background not of remembrance of the 1930s downturn, but of the 1984-92 reform period.

Our economy had to undergo massive changes back then, including the removal of support for some sectors which were being propped up in unrealistic fashion – farming and manufacturing. The support structures were removed, businesses collapsed, people were thrown on the scrap heap. And they were left there.

No big effort was undertaken to find them jobs elsewhere or to retrain them. They were pushed aside first as people enjoyed the unsustainable credit and sharemarket boom of the 1984-87 period, then by the collective woe post-1987 as people saw their personal wealth decimated by a sustained collapse of share prices.

The current government will be determined to make sure that does not happen again. There is an opportunity to remove part of the stain of the fourth Labour government. The people who do lose their jobs will find a level of effort to reposition them elsewhere of magnitude not seen before. And it starts with the measures of recent weeks aimed at carrying as many jobs as possible through to the other side when people will likely have a more realistic grasp of the situation and will not as deeply feel the need to lay off most of their staff because we are all going to get sick and many die from the virus out of China.

In a nutshell, the efforts by the government and the Reserve Bank are massive, and pundits trying to scare you with their prognostications are probably failing to sufficiently take those counter-balancing forces against the virus' effects into account.

Emailed Queries

Buying in Queenstown and Wanaka

I was asked whether now is the time to buy the property one has been planning to buy in this beautiful part of New Zealand. Personally, I'd wait – unless I was given a good price discount right now by a builder desperate to sell a spec job and get the bank off their back.

We know the inbound tourism market has gone and won't be back for a long, long time. Many people will look to shift elsewhere to set up new businesses – probably in the cities. But they will take some time to adjust their house price expectations downward. Some time will also be required for the SME owners who bought holiday homes to make the decision to sell in order to shore up their city businesses. These decisions can be very slow in coming, damaging as they are to one's psyche.

So, my best guess is that the low-point in the Central Otago Lakes house price cycle is nearer year-end than in winter.

And keep an eye on Queenstown's "commuter" townships where workers have had to rent or buy in recent years and commute from each morning. Some price "adjustments" will be coming there.

In the US, Will Wealth Being Freed Up from Dead People Boost Recovery?

I've never seen any research on a positive wealth effect from old people dying and their wealth becoming available to younger people. If there is such a wealth effect it is likely to be spread over time as there is no strong reason for believing people who unexpectedly inherit money spend it straight away. More importantly, whatever the size such a wealth effect may be it will pale into near complete insignificance alongside the loss of wealth from lower share prices, the loss of wealth from lower house prices, the loss of income from reduced employment and wages, the loss of company profits from reduced revenue, the fiscal stimuli from the Federal government, and the monetary and liquidity/funding stimulus and support from the Federal Reserve.

How Does Printing Money Boost Share Prices?

There are two main ways. The first is by keeping interest rates at low levels. Low rates of return on low risk assets like term deposits and bonds encourages people to seek higher yields elsewhere based on a level of yield they are seeking which is probably not relevant any longer. Money flows into property and stocks.

The second is simply via spare money sloshing around the system. The way money printing works is that people with funds they were going to use to buy government bonds find that the central bank has already bought them. They miss out. The printed money is in fact that cash left sitting in someone's bank account. That person is by definition an investor – as opposed to the person who received the extra government money in the first place (handouts, subsidies, job programmes etc.). They will look for somewhere else to invest that money.

Some will find its way into property, some into shares. The central banks desire is that some finds its way into consumer spending, business capital expenditure, and maybe hiring.

It's a scattergun approach and that is perhaps one key reason why sharemarkets have rallied so strongly since the third week of March. Central banks have entered a mode of panic regarding the effects of the virus from China so are throwing as much money as they think they can get away with at the problem.

Does NZ Have a Bank Deposit Guarantee?

In December the Minister of financed announced that a scheme is planned involving cover up to $50,000 per person per banking institution but that extra consultation would be undertaken. So, a scheme is planned but it is not in place yet.

Will the RMA be Altered to Hasten Infrastructure Spending?

The Greens will oppose such moves but they sit outside cabinet and the way things are going Labour might not need any partners after the September general election – though we know things can turn quickly as happened ahead of the 2017 general election. Labour are likely to focus far more on their traditional working-class base than the newer city-based liberal section. That means willingness to undertake moves which will promote jobs growth sooner rather than later. In Australia spending on renewable energy projects has slumped.

Will the government remove the ban on foreign buying of existing NZ houses?

No. Many people will find their home ownership dream destroyed or delayed for years by the current recession. If the government let foreign buyers back in, we would expect upward pressure on prices which, whilst good from a positive wealth effect on spending, would make home ownership even harder to achieve for many Kiwis.

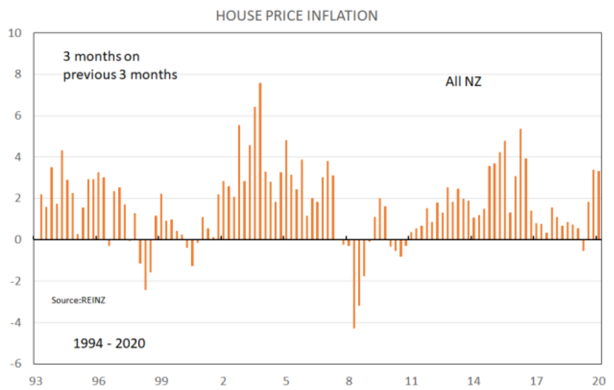
How soon after going into recession do house prices start falling?

House prices fall at about the same time as GDP declines. GDP started falling in 1997 Q3 for the

Asian Crisis and house prices on average nationwide started falling from Q4. Ahead of the GFC we went into recession from 2008 Q1, but because mortgage rates were near 11% house prices started falling just before that in 2007 Q4. So, let's say prices start declining at the same time. That means when we get average price figures it seems reasonable to expect they will show prices on average as falling right now.

Note that the economy came out of recession in 1998 Q2 and prices started rising in 1998 Q4 – so a six-month lag. But following the GFC the economy started growing in 2009 Q3, yet prices started rising from 2009 Q1. So, let's say that prices tend to rise at about the same time as the economy starts growing.

In fact, here is a graph showing quarterly changes in NZ house prices from 1994 to 2020. Periods of price decline are rare, and they are short-lived. Opportunities to buy in a weak market don't last long.



New Zealand's Housing Markets

Beware the Outliers

It's going to be some time before we get data giving us good insight into underlying trends in the NZ housing market. Those underlying movements are what we economists look for – not the monthly ups and downs which can be all over the place.

We know that sales will fall during the lockdown. But how much do sales normally fall when we have a pandemic breakdown? We do not know. Therefore, we have no ability to say that a fall of x% seems unusually strong or unusually weak considering the lockdown.

Similarly, once we come out of lockdown, we will see sales jump up. But by how much do property sales usually jump up when we exit a pandemic lockdown? Again, we don't know. And what about sales during Level 3 alert as opposed to level 4? No idea.

I do not expect to be able to look at the data on turnover and days to sell and deliver you informed commentary about whether my underlying views need to change until sometime very late this year.

But what about prices? We know that changes in the mix of properties being sold will move the median and average price calculations around. That is why I don't use such numbers, whether they are produced by REINZ, Trademe, or anyone else. I only look at the REINZ's House Price Index changes to get a feel for how prices are changing.

In theory these measures should not be affected by changes in the mix of properties sold. However, what if there are hardly any of a certain type of house sold during virus alerts? The indexes will be distorted because they won't be able to truly capture where the market is going. We won't have equally up to date price gauges for all house types.

What that means is that I will certainly pay attention to monthly House Price Index measures from REINZ when they appear toward the end of every second week of the month. But I will be treating the changes with a high degree of suspicion.

So, why write this? Because I think I know what is going to happen over the next few months, having seen different versions of this point in the housing market "cycle" many times over the past three decades.

The media – mainstream or social – will highlight the biggest price declines. I expect to get calls from journalists asking for comment on such and such a property which just sold for 20% less than the price some poor beggar paid for it 6-12 months ago. This is what I experienced over 2017-18. I'd be given an example of a house selling for about 20% less and asked to comment.

But there are always places selling for prices vastly different from RV, vastly different from what people expected heading into an auction, and vastly different from what some excessively optimistic highly geared person paid for it the previous year.

Despite the 2017-18 examples I was given for Auckland, average Auckland prices in 2017 rose 0.3% and in 2018 fell 1.2%.

Over the next six months you will see reports of some big price declines – in Auckland and elsewhere. But they will not represent the true picture for the relevant markets overall. Stay focussed on the long-term factors and don't be dragged into making panicked decisions because of a headline you've just seen.

But many people will. They will be the same type of people who permanently reduced their retirement wealth 4-5 weeks ago by switching their KiwiSaver scheme from an aggressive fund to a conservative one.

Long-term investors know these panicked decisions to sell and not to buy will happen, and that is why they have already been contacting real estate agents expressing their interest in rushed sales.

Try your best not to get dragged into the negative psychology of this temporary recession period. In fact, avoiding the negative commentary was one of the strongest pieces of advice supplied by respondents to the survey request I sent out Wednesday a week ago. Most of you will already have received my write-up of the 89 responses on Monday morning. For those of you who are new

subscribers and did not you can find the results here.
http://tonyalexander.nz/resources/TV%20Covid-19%20No.7%20Supplement.pdf

Examples of what respondents wrote include these, in response to my question regarding what was a waste of time back in previous recessions.

- "Reading lots of media doomsday articles, unemployment rate projections, death tolls, how bad things are going to be. Wasted energy and I have no influence over these things anyway. Limit media exposure."
- "Listening to all the different scenarios that "could" happen as opposed to what was actually happening at the time."
- "Worry and listening to ill-informed media who continue to exaggerate and spread fear and make it worse"

Keep your focus on the long-term fundamentals. Do not get drawn into the panic pool so many people want you to swim in.

And what are those long-term fundamentals? Here's a few.

1. Mortgage rates have fallen to record lows and may sit at these levels for 3-5 years.
2. Rates of return on investments other than residential property have just fallen anew and displayed unsettling volatility.
3. There are shortages of dwellings in our main cities.
4. Real estate agents are reporting increased enquiries from Kiwis offshore looking to return home. At the same time the long-term attraction of living overseas has diminished.
5. House supply growth will slow over the coming year as banks restrict property development finance and willingness of builders to undertake speculative construction decline.
6. Our central bank has engaged in money printing for the first time and experience overseas post-GFC shows some of this excess money finds its way into asset markets.
7. Loan to value ratios are almost certain to be cut or removed when the Reserve Bank completes seven days of consultation following their announcement of such on Tuesday morning.

However, let's not forget what has just happened over the past four years while Auckland was on pause. I said from 2017 that if you wanted excitement in your housing transactions, you'd best head to the regions because they were about to embark on a catch-up period of price gains. They have done that.

But I also warned that every time this happens people get overly optimistic about how many people will actually leave the big cities and go to the regions. Over-investment occurs, excess sections get developed, prices go too high. Corrections inevitably happen and sellers can vastly dominate the number of buyers. I've already received an anecdote from a journalist regarding one part of the country I have mentioned many times these past four years experiencing a surge in the number of advertisements of properties for sale. I've yet to verify that however.

The regions will now undergo their cyclical reality check periods. The trigger is the virus from China. The aggravating factor is collapse of inbound tourism which has been the saviour for some locations, and a bonus for others. Add in what looks like permanent reductions in regional flight services, and suddenly retirement to the regions – yet again – does not look as attractive to city-based Boomers. And add in also the tendency for people to leave the regions during recessions to look for work in the cities.

So, if you are planning to retire to the regions from a city and free up cash – I'd be in no hurry. The panicking investors are already looking to sell. But it takes some months for frustration to set in and real vendor willingness to move on price appear.

And one more thing. Each cycle too many houses tend to get built in the regions. I think that if were I a Boomer shifting to the regions it is at those new developments I would look. Small spec. builders needing to save their businesses in the face of banks cutting all extra finance will have no choice in coming months other than to sell for whatever they can get.

Let's keep going on the regions versus Auckland theme. Since the end of 2016 average Auckland house prices have risen by 7% while in the regions, they have risen by 30%. Auckland is looking far less over-priced now than four years ago.

Investors flocked to the regions from 2016 for two reasons – yield and because the LVR rules required a 30% deposit and that was a big lump in Auckland. If and when the LVRs are scrapped, Auckland once again to an investor becomes highly affordable.

In summary for those interested mainly in Auckland

-strong long-term population growth assisted soon by returning Kiwis
-investor flow to the regions reaching its natural cyclical end
-existing housing shortages
-scrapping of LVRs making Auckland much more affordable to investors and first home buyers

One Final Thing

Go back 3 pages to my answer to the question regarding correlation between GDP falling and house prices falling. They tend to move together. And it looks like they move reasonably closely on the way up also. That is why you are seeing forecasts of house prices rising over 2021. Treasury for instance predict that after shrinking 10% this calendar year we will grow 9% next year then 6% over 2022 assuming 4 weeks at Level 4, 4 weeks at Level 3, plus an extra $20bn of government spending.

Keep your head while the doomsayers are predicting extended price declines and you may make some canny purchases this year. This is why the long-term well capitalised investors were on the 'phone to real estate agents a month ago expressing their interest in bargains from people looking for quick sales.

Further Reading

- I have a fortnightly column on the housing market in the Sunday Star-Times.
- In this publication of March 30, I listed as many negatives and positives for the housing market as I could fit on four pages. http://tonyalexander.nz/resources/TV%20Covid-19%20No.4%20Supplement.pdf

Interest Rates

Last year the Reserve Bank reacted to a surprising drop in business confidence by cutting the official cash rate from 1.75% down to 1.5%, then initiated a rare 0.5% cut to 1.0%. The fundamentals of fickle sentiment did not justify the cuts and now the RB will likely be breathing a sigh of relief that the Covid-19 crisis has dug them out of a policy hole.

This week we learnt that the inflation rate jumped to 2.5% in the March quarter. This resulted from the 0.8% increase during the three-month period being about twice market expectations and above the Reserve Bank's forecast of 0.5%. Core inflation measures showed the same sort of jump so we can be confident that inflation was rising heading into the current crisis.

Now however, everything has changed and the RB will not need to be thinking that rates will need to be pushed higher later this year. Such cutting then quickly reversing the move is not something unknown in the world of monetary policy here and overseas, and neither is raising rates then cutting them quickly when inflation fails to appear. This happened over 2010-11 and again over 2014-16.

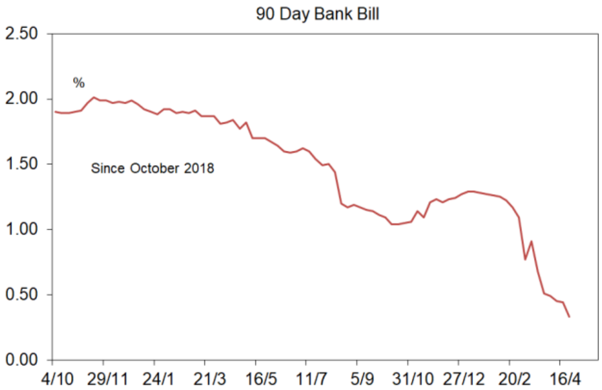
The weak environment we now face means that inflation won't be a problem for quite some time, and based on the post-GFC experience deflation is likely to more commonly occupy the minds of policy setters.

The relevance of this to you is that it means interest rates you pay on your mortgage, overdraft, or core business debt, will remain very low for a good number of years. It also means that if you are a term depositor your returns will remain low for many years.

The post-GFC experience tells us that sustained low interest rates eventually stimulate asset markets – shares and property particularly. The post-GFC environment also tells us that money printing eventually boosts asset prices also.

So, that adds up to whatever the short-term downward pressure on house prices turns out to be, from a long-term investment point of view for fresh buyers it is good news.

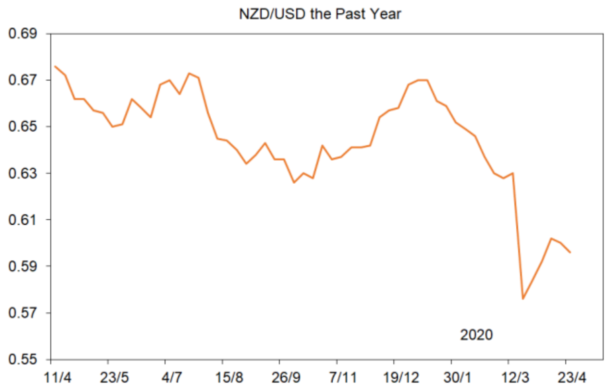
For the record, this week the yield on 90-day banks bills, which heavily influences overdraft and floating mortgage rates, ended near 0.33% from 0.44% last week. This decline came mainly in response to comments from the Reserve Bank Governor indicating he has not ruled out negative interest rates one day. I'd view that more as what we used to call an "open mouth policy" or jawboning aimed at assisting the goal of keeping medium to long-term borrowing costs low, than actually signalling an OCR below 0%.

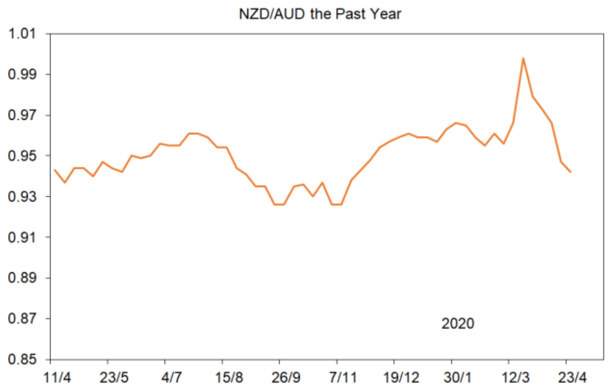


In response to the Governor's comments swap rates have also fallen a bit this week, with the three-year rate for instance declining to near 0.38% from 0.48%. In the wholesale markets these moves are of significance. But in the retail markets where they form the base from which fixed mortgage rates are calculated, they don't amount to much in the broader context of your mortgage rate considerations.

NZ Dollar

The NZD has ended this afternoon against the greenback near 59.5 cents from 60 cents last week and 58.5 cents a month ago. Support for the NZD came from the Prime Minister's announcement that we will come out of Level 4 alert next Tuesday. But monetary policy comments applied mild downward pressure. Basically, the NZD is range-trading against the USD.





Against the Aussie dollar we have ended near 94.2 cents from just below 95 cents last week and 98 cents a month ago. One factor causing the NZD to lose some ground is the greater degree of money printing expected in NZ than across the Tasman.

CHOOSING YOUR FIXED MORTGAGE RATE TERM

No changes from last week.

When fixing a mortgage rate term most people take whichever rate is the lowest. So, each week I shall calculate what rates would have to be in the future to make this option better than some alternatives. Note, there are far, far more alternatives than calculated here. And always remember, it is worth paying a premium for rate certainty over a longer period of time. It's also worth using a broker to get the best deal. Broker use is far higher in Australia than New Zealand but we will probably catch up.

Current minimum fixed rates across the main banks. *

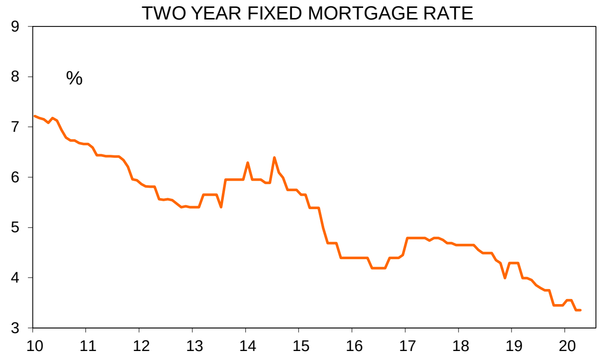
1 year	3.05%
2 years	3.35%
3 years	3.65%
4 years	3.79%
5 years	3.89%

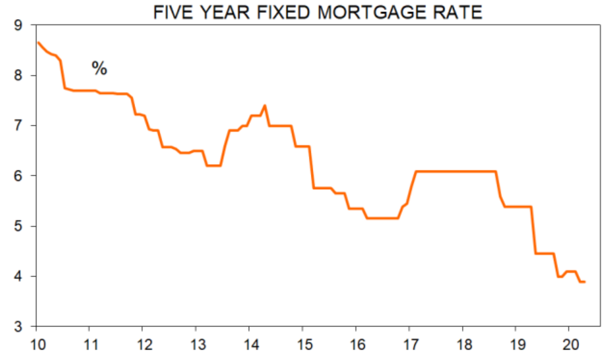
I can fix 1 year at 3.05%.

Is this better than fixing 2 years?	Yes, if in 1 year the 1-year rate is below 3.65%.
Is this better than fixing 3 years?	Yes, if in 1 year the 2-year rate is below 3.95%.
Is this better than fixing 4 years?	Yes, if in 1 year the 3-year rate is below 4.04%
Is this better than fixing 5 years?	Yes, if in 1 year the 4-year rate is below 4.10%.

Is it likely that in one year's time the one-year fixed rate will be above 3.65%? No. So if two years was as far out as I was looking, I would personally opt to fix one year currently. In a year's time what are the chances that the two-year rate is above 3.95%. Again, not strong. So, I again would fix one year then look to fix two years one year from now if a three-year exposure was my preference. We Kiwis tend to fix at whatever the lowest rate is, and the balance of probabilities suggests doing just that currently will yield the lowest debt cost for the next few years. However, I personally am a conservative borrower. If someone were to offer me a three-year fixed rate at 3.3%, I'd probably take it.

*Minimum 20% deposit, owner occupiers, 6 largest lenders.
Compounding is minor so is ignored.



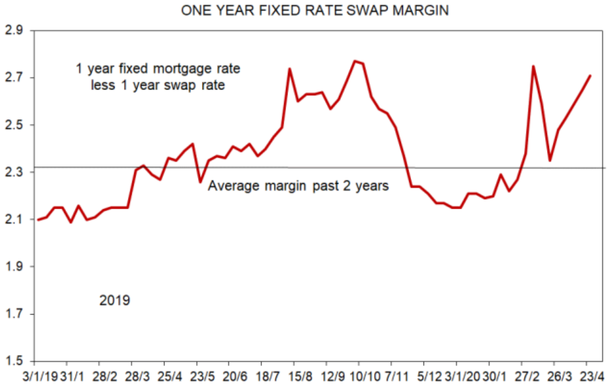


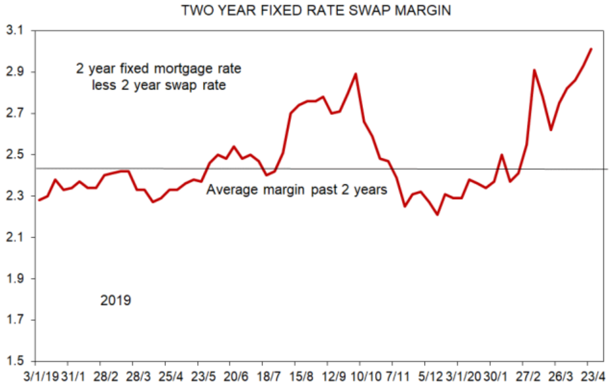
IS A FIXED RATE CHANGE IMMINENT?

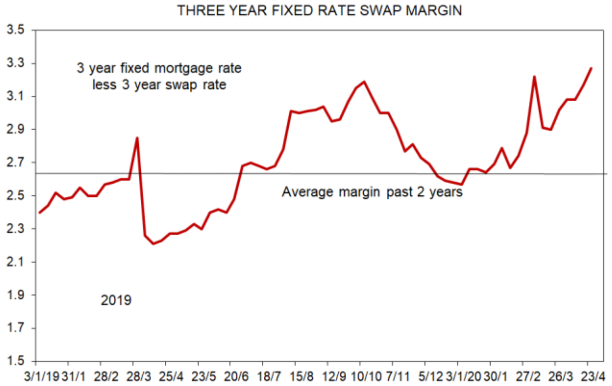
No change.

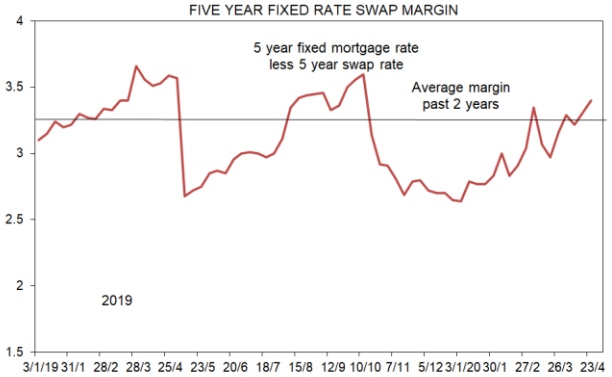
I do not believe so. Bank non-swap rate funding costs have risen in this new uncertain global credit risk environment. In a visual sense that would mean the most recent data points in the red lines in the four graphs below are actually a lot lower than shown. The extent to which margins are above average for the 1-3-year terms is a lot less than implied here. That, taken in conjunction with banks pulling back from attracting new business, and past instances of margins staying well above average for extended periods, says to me further rate cuts from current levels are not very likely.

You can form your own opinion as to whether banks might be about to raise or lower their fixed rates by looking at the following graphs. They compare published fixed rates with the most frequently changing component of the total cost of funds – the swap rate. Note that there are other funding costs which will not be captured here, but they change infrequently. But be warned. There is no real forecasting insight delivered by a thing (equity, exchange rate etc.) moving further from some concept of fair value or average. If a thing is 10% above trend, it might simply be on its way to being 40% above trend. For good bank rate comparisons access www.interest.co.nz









Are You Seeing Something I'm Not?

Don't be afraid to flick me an email at tony@tonyalexander.nz if you reckon I'm missing something happening in the economy, or you've got experience or insight into some of the developments underway which you'd like to share.

Online - It's A Family Thing

For your guide, in my family it is not just myself communicating and informing people principally online and working from home. **(Well its all of us now for at least four weeks isn't it!)**

My wife Dr Sarah Alexander manages the network of early education and care services around the country (www.ChildForum.com) and the website for parent ratings and reviews of children's services (www.myece.org.nz).

My daughter Lilia Alexander (finalist in the Youth category for Wellingtonian of the Year 2019) owns and runs Social Media based Wellington – LIVE (160,000 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.
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DETAILED GRAPHS ENLARGED

None this week.