TONY'S VIEW

Input to your Strategy for Adapting to Challenges

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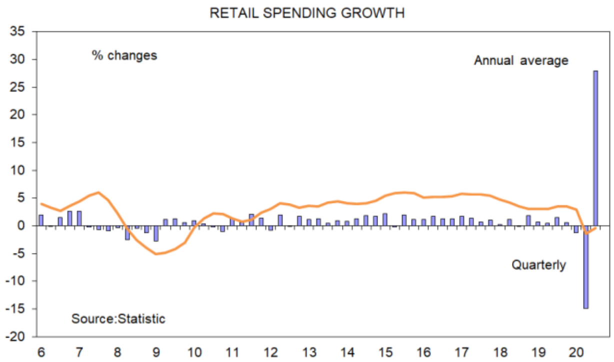
My Aim

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.

Spending Surges

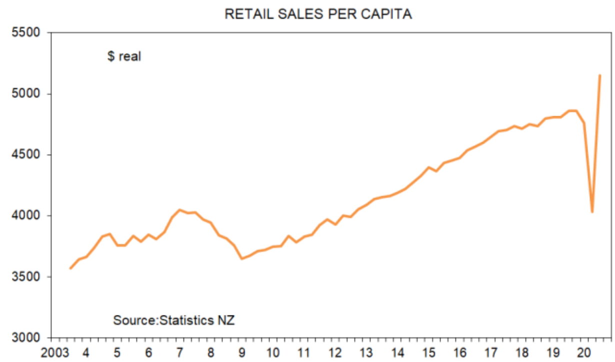
We learnt this week that during the September quarter retail spending volumes around New Zealand rose in seasonally adjusted terms by 28%. This followed a 15% fall in the June quarter and 1.2% fall in the March quarter.

This is what my usual graph showing retail spending growth looks like. Plain stupid now.



The huge surge means that spending in the most recent quarter was 8.2% ahead of a year earlier after being 14.1% lower in the June quarter.

This next graph perhaps shows the situation better. It displays real per capita spending each quarter.



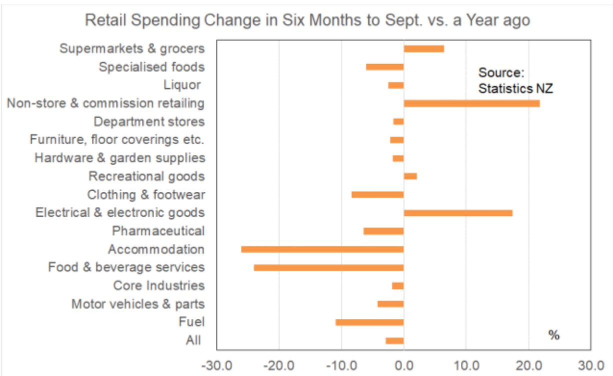
You might look at the graph and say that we more than caught up on the spending we did not do during the June quarter. That is not so. Over the December and September quarters last year real retail spending per capita averaged $4,860. Let's assume that is what the June and September quarters would have been, plus another 0.5% to allow for income growth.

June quarter 2020 spending was about $850 less than we would have expected and September quarter about $269 more. But that means over the two quarters, total spending was 850-269 = $582 per person weaker than it should have been.

We have not caught up on all of the spending we put off. But let's look at this in a tad more detail.

For each type of store, we can add the two latest quarters together and see how they compare with a year earlier. We see that total sales in the past half year were down by 2.9% from a year ago compared with annual growth of 2.2% six months earlier, 3.6% six months before that, and 3.3% 18 months ago.

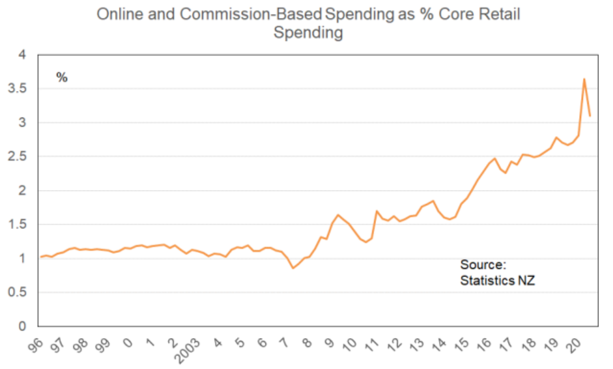
But this fall is not the case for all categories of store types. Over the six-month period spending at supermarkets and grocery stores was 6.4% ahead of a year ago. We have restocked our larders though this mainly reflects a jump in spending ahead of lockdown which we seem to have sustained. More home cooking probably on an ongoing basis.



We can see that the non-store retailing category has enjoyed sales 22% ahead of a year ago. In the words of Statistics NZ…

“Non-store retailing consists of units mainly engaged in retailing goods without the use of a shop front or physical shop presence. Examples are sole e-commerce retailers and direct online shopping businesses in New Zealand. Commission-based units are engaged in selling goods to the public on a fee or commission basis.”

We have sharply increased our online shopping. The trend is upward, and the chances are that this proportion will continue to rise over time as is happening all around the world.

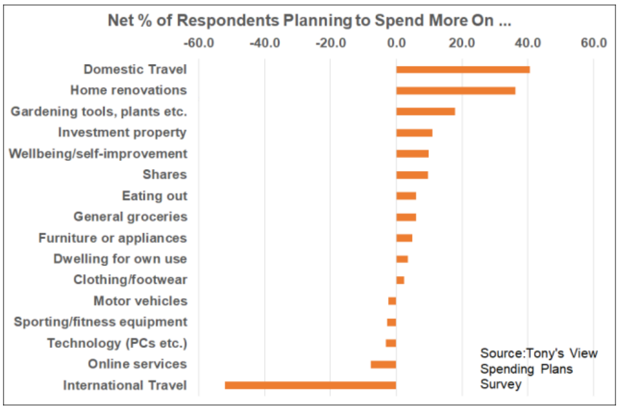


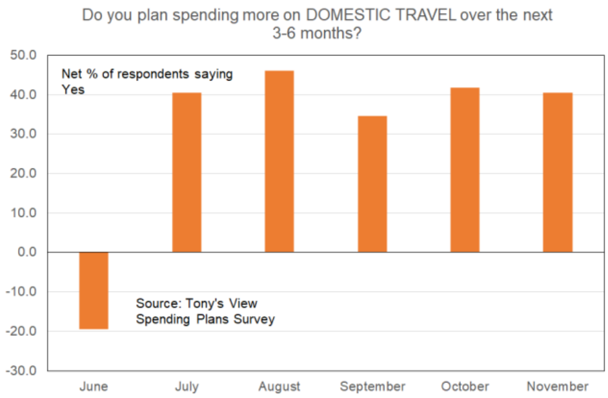
We have increased our spending on recreational goods 2% from a year earlier in total over the six months to September. This reflects our switch toward recreating at home and within New Zealand rather than travelling overseas and perhaps eating out. Maybe there is a new focus on healthy activities in the outdoors – kayaks etc.

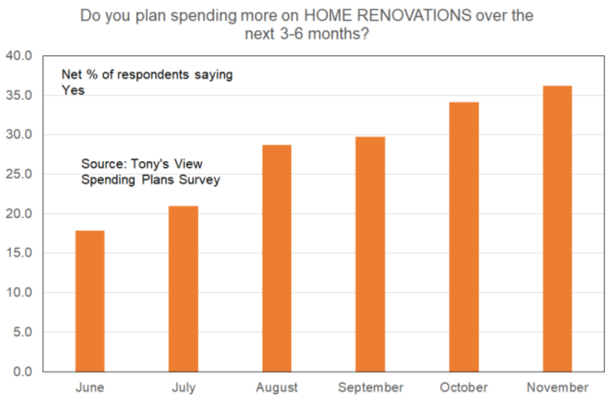
We spent 17% more on electrical goods in the past six months compared with a year earlier. This has been driven by our focus on improving our nests, money diverted from offshore travelling, getting more comfortable in case of another lockdown.

Can these types of stores reasonably expect their strong sales to continue? To help answer that we can look at results from my monthly Spending Plans Survey.

It told us three weeks ago that we intend spending a lot more on domestic travel, which is understandable while we continue to face closed borders. Sales for hardware stores have held up very well recently and that relative strength looks likely to continue given the high intentions to spend on home renovations and gardening supplies.

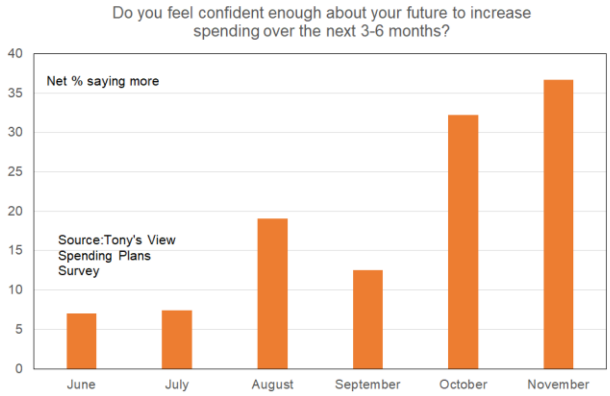




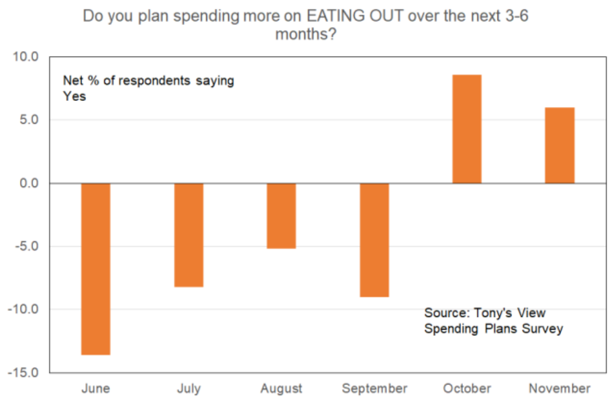


For electronic goods a strong outlook appears reasonable given positive intentions to spend on furniture and appliances. Having said that, this category as worded clearly more refers to couches and fridges than televisions and PCs so the correlation with the boom in electronics sales is not that great I suspect. But the positive result nonetheless suggests stores selling furniture and whitewear can anticipate good summer sales and perhaps for some large stores these departments will start catching up on their booming electronics areas.

The overall result from my Spending Plans Survey you may recall was a net 37% of respondents saying that they intend spending more over the next 3-6 months. For retailers the outlook seems good.



This may even be the case for those in the hospitality sector in terms of growth perhaps more than the actual level of activity when compared with a year earlier.



TONY'S VIEW

New Zealand's Housing Markets

The Impact of Restored LVRs

The Reserve Bank yesterday said they will be reinstating LVRs from March 1 next year at the levels and exclusions they were at before removal from May 1 this year. What will the impact be?

Actually, banks have already put the LVRs back in place now or effective in two weeks, so the question is best phrased not as what will be the impact from or ahead of March, but what will the impact be now?

To gain insight we can look at how the market was tracking before the LVRs were removed. I've done this analysis before in order to show that as a result of events in 2019 the housing markets around the country were accelerating late in 2019 and early this year. We hit Covid-19 with strong momentum in the housing market and in particular with Auckland re-entering the upward part of its house price cycle.

Those propelling events in 2019 included the following.

1. A 0.75% cut in the official cash rate between May and August. The average two-year fixed mortgage rate fell from 4% to 3.6% on a continuation of a decline from 4.5% mid-2018.
2. We could see that the imposition of a ban on foreign buyers from October 2018 was having no obvious negative impact.
3. There was not a falling away of net migration flows which many people were talking about over 2019.
4. The government confirmed that they would not introduce a capital gains tax.

I have previously noted these following numbers. On average during each of the four quarters of 2019 house prices in Auckland rose by 0.5%. In the March quarter they rose 3.5%.

Around NZ excluding Auckland, price rises averaged 2% a quarter in 2019. They rose 3.3% during this year's March quarter.

So, what do we have now as a baseline given LVRs are back in place? This first list contains factors suggesting extra housing market strength from what we were seeing pre-Covid.

1. Average mortgage rates are even lower with two-year fixed rates around 2.5% from 3.4% in March.
2. Kiwis have an extra $10bn available to spend because we are not travelling overseas.
3. Term deposit rates have fallen substantially with the average two-year rate going from 2.4% in March to 0.9% now.
4. We have learnt that the stack of frustrated buyers looking to take advantage of any buying opportunity is much greater than we thought.
5. Most people expect net migration inflows to soar once the borders reopen perhaps at the start of 2022.

This list looks at new price-restraining factors since the March quarter.

1. Net monthly migration flows for now are nearer zero than the old average near 4,000.
2. The government has removed the ability of councils in big cities to prevent six storey apartment buildings in areas near mass transit and commercial centres and removed carpark requirements.
3. The Finance Minister has asked Treasury to look at extra ways of restraining house prices. An extension of the brightline test from five years to seven or ten years is likely.
4. Average house prices are now higher than they were in March by 8% in Auckland and 6.5% in the rest of the country.
5. The unemployment rate has risen from 4.2% to 5.3% with a further increase to 6.4%

possible according to the Reserve Bank's most recent forecasts.

6. House construction may register no fall as a result of the Covid shock and in fact face boom years as buyers flock to new builds rather than tirelessly attending Open Homes of used houses.
7. The investor LVR will probably be lowered from 70% to 60% as happened in 2016.

There is no model which can tell you where house prices will go in light of all these factors. Instead it all comes down to personal judgement and mine is this.

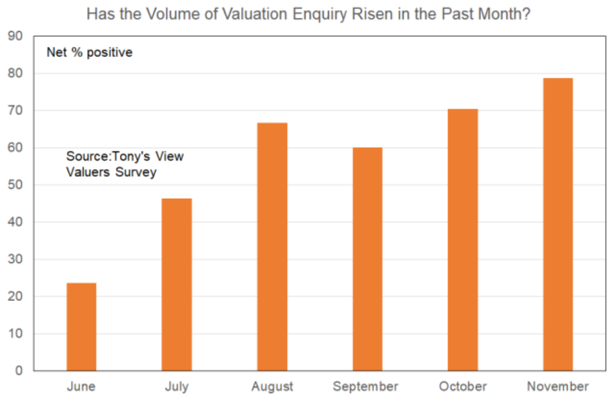
Low interest rates, expectations of migration booming again one day, and revelation of a huge degree of pent-up demand will dominate the other factors in the short-to-medium-term.

I expect prices to keep rising, but at a slower pace than over the past five months. As I noted last week, for the country as a whole, house price inflation averaged 1.1% a month heading into Covid-19 and has averaged 1% a month over the seven months since. I expect that 1% a month will be the outcome of a monthly calculation we will do for all-NZ in a year's time.

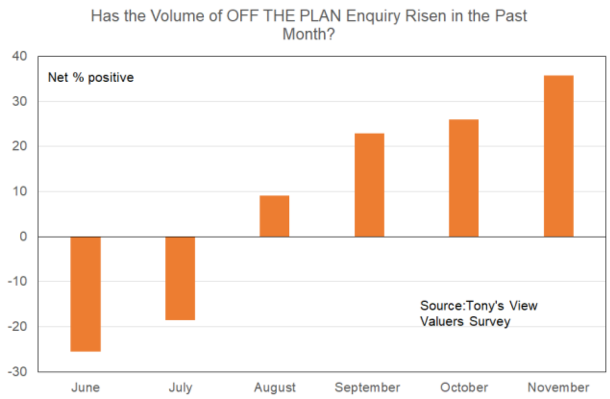
Valuers Views

This week I ran my monthly survey of valuers and they have provided insights which allow us to place more flesh around the bones of the current housing market.

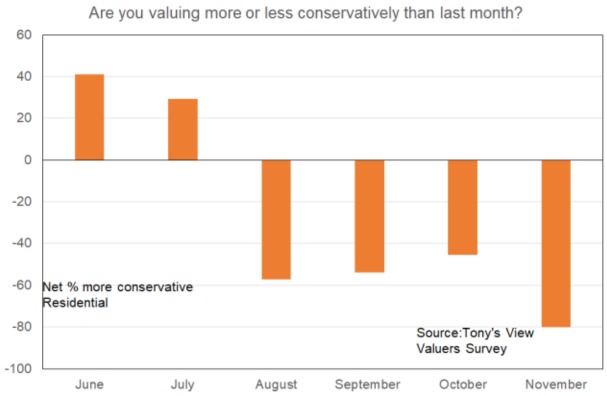
First, property valuers are getting busier with a net 79% saying levels of enquiry are up. This gels with the reports of many people looking to purchase both residential (net 100% up), and commercial (net 60% up) property.

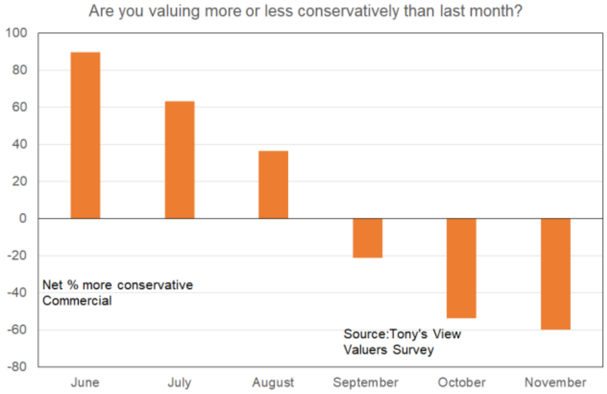


A net 36% say they are seeing more enquiry for pricing of property off the plan. This generally refers to giving an estimate of what something will be worth if constructed and as such bespeaks of rising supply, which is a good thing in the context of the current frenzied market.



The impact of rising prices can be seen in the net 75% of valuers who report that they are valuing less conservatively. That is, in the face of so much uncertainty regarding the state of our economy and property markets, they are increasingly leaning toward the side of prices rising rather than falling. The following two graphs show the results for residential then commercial valuers.





A net 93% of valuers feel that property prices are rising. This result is a net 100% for residential property and 80% for commercial property.

In other words, it is not just on the housing side that things are relatively heated with a lot of buyer interest. People, investors, are also on the lookout for commercial property.

Tview Premium contains insightful comments offered by valuers.

Interest Rates

Tview Premium this week contains an extensive discussion of the interest rates outlook and why I favour fixing five years, in the context of the exchange of letters between the Finance Minister and Reserve Bank Governor. The discussion amounts to this selected snippet.

Regular readers will know that I have remained a fan of fixing my mortgage (if I had one) at 2.99% for five years and forsaking the candy of fixing just one-year for less than 2.5%. There are four reasons behind my thinking.

First, these are very uncertain times, and I am prepared to pay a small premium for certainty in what would be my biggest single expense.

Second, the risks do not favour a negative cash rate and as our economy strengthens wholesale interest rates will start creeping up again.

Third, margins on fixed rate loans have been moving to below average levels and scope for further declines has been getting smaller and smaller.

Fourth, virtually all interest rate forecasts on the planet have been wrong since 2007 – invariably on the high side. At some stage our errors will shift to predicting inflation too low and we will get surprised with high inflation and central banks having to tighten unexpectedly rather than ease.

We have now reached the situation where most pieces of data released on our economy are coming in better than expected. Our economy has weathered the Covid-19 storm well. Optimism about future growth is rising as news rolls out regarding successful vaccine trials, and expectations are growing for our borders opening about 12 months or so from now….

Currently, it remains reasonable to assume that in line with some strong comments from the likes of the Reserve Bank of Australia, the cash rate stays at 0.25% until early 2023… But my money is on the RB being forced to raise it before then, probably in 2022.

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