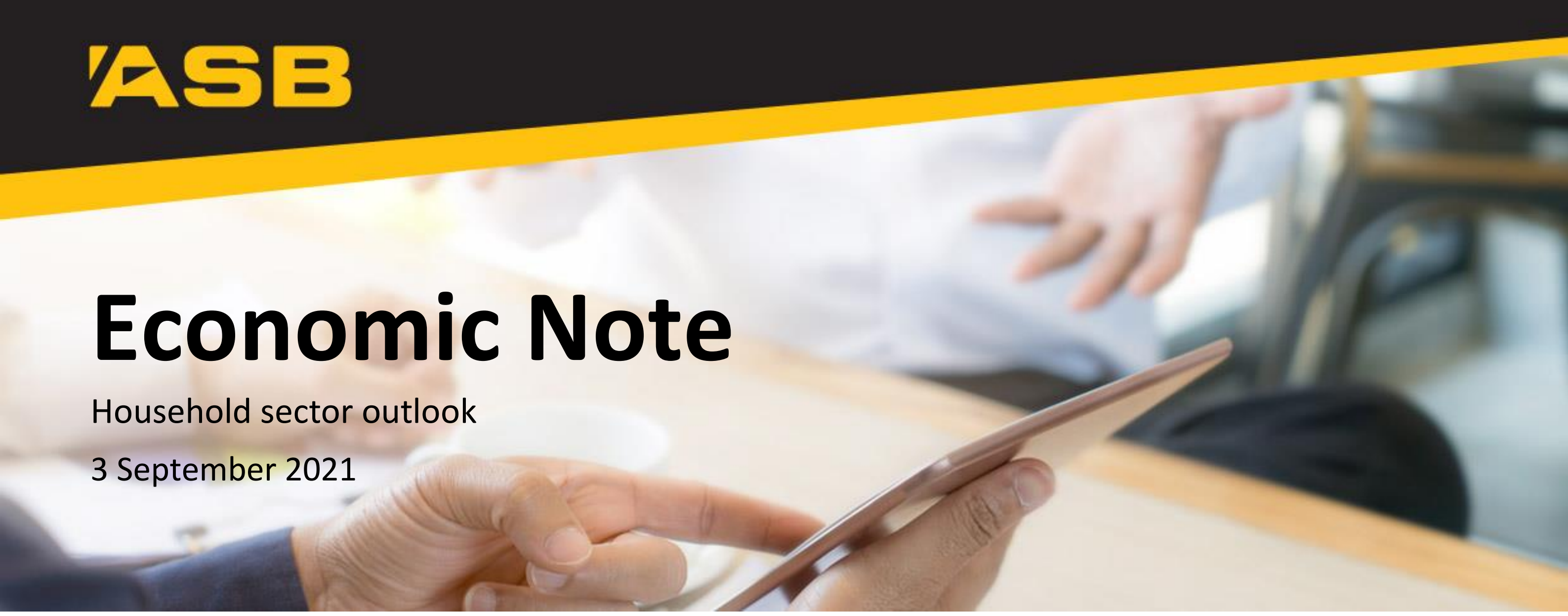


Economic Note

Household sector outlook

3 September 2021

Riding out the (lockdown) storm

- The current lockdown/tightening of Alert Level restrictions will cool strong momentum in household sector activity.
- COVID-19 adds uncertainty to the outlook, but firms and households have been here before.
- Provided the lockdown does not drag on, we expect a strong post-lockdown bounce in household spending and overall GDP. Households should prepare for higher borrowing costs.

Summary

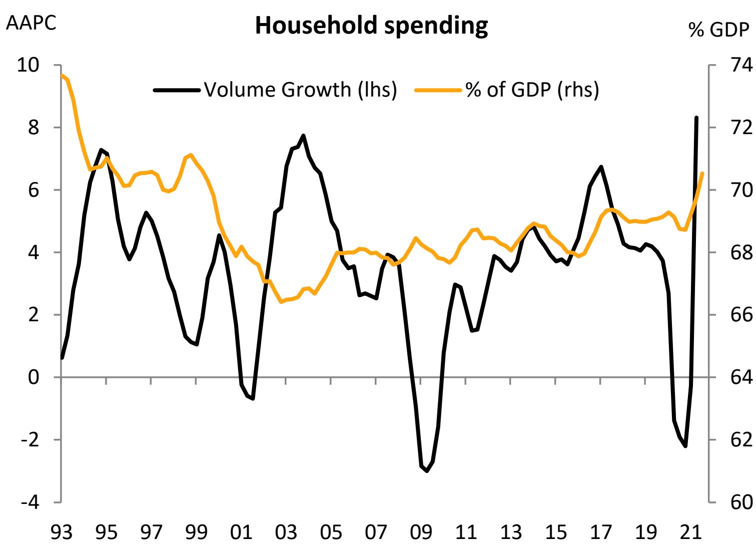
The household sector has been at the forefront of the domestic post-COVID-19 expansion. The combination of strong household balance sheets, increasing household incomes, record low average interest rates for the household sector and Kiwi's love affair with property and durable spending has been in evidence. This has resulted in a strong momentum in economy-wide household spending and economic overheating, notwithstanding the significant post-COVID-19 hit to many NZ firms and households.

The recent delta variant outbreak and subsequent lockdown have cooled things down. A number of households will bear the brunt. Uncertainty is high, but firms and households have been through this before and are generally resilient. Providing the lockdown is short-lived (weeks rather than months), our view is that household spending will be temporarily dampened, followed by a decent rebound. Households should prepare for higher borrowing costs.

Recap

Since COVID-19 came on the scene we had been impressed by the resilience of the NZ economy**. A large part of this has reflected a buoyant household sector, with household spending rebounding strongly from its mid-2020 dip**. Since the Household spending makes up about 70% of the economy, where the household sector goes, the economy tends to follow.

Household spending retained considerable momentum over 2021, notwithstanding tightening restrictions in Auckland earlier this year. Retail volumes hit record highs in the June 2021 quarter, with volumes increasing at a 7% to 8% annualised pace in the first half of the year. Durable spending is running at close to double that pace. The buoyancy in retail spending **reflects a combination of income, balance sheet and cashflow-type tailwinds.**



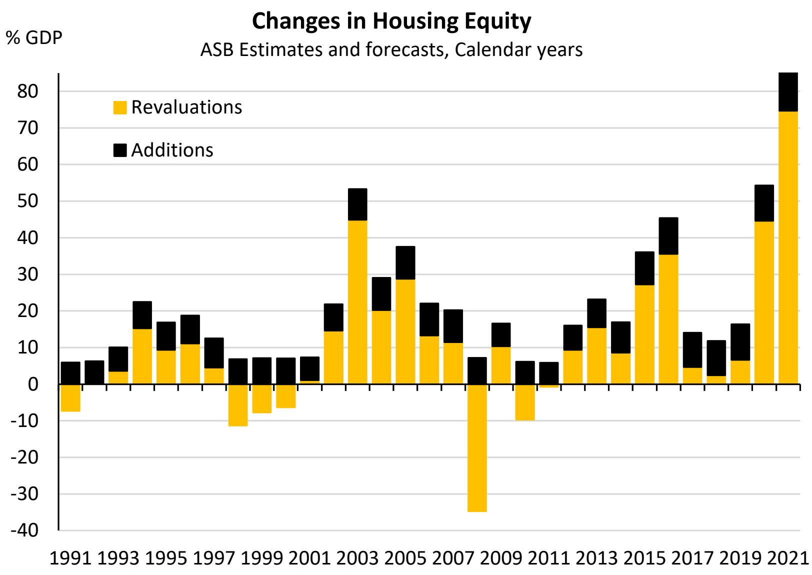
Source: Stats NZ, ASB

Mark Smith – Senior Economist   (649) 301-5657 mark.smith4@asb.co.nz

Stronger Household balance sheets

Household balance sheets in aggregate have done very well post-COVID-19. It is little coincidence the resilience in consumer spending (and durables spending in particular) has coincided with this.

Latest figures from Statistics NZ place the value of household assets in the March 2021 quarter at approximately $2.5 trillion, roughly $1.3m per household. Net worth for the household sector sat at $2.3bn, approximately $1.2m per household. Since late 2019, household assets and net worth have increased by close to $500m (roughly 25%).



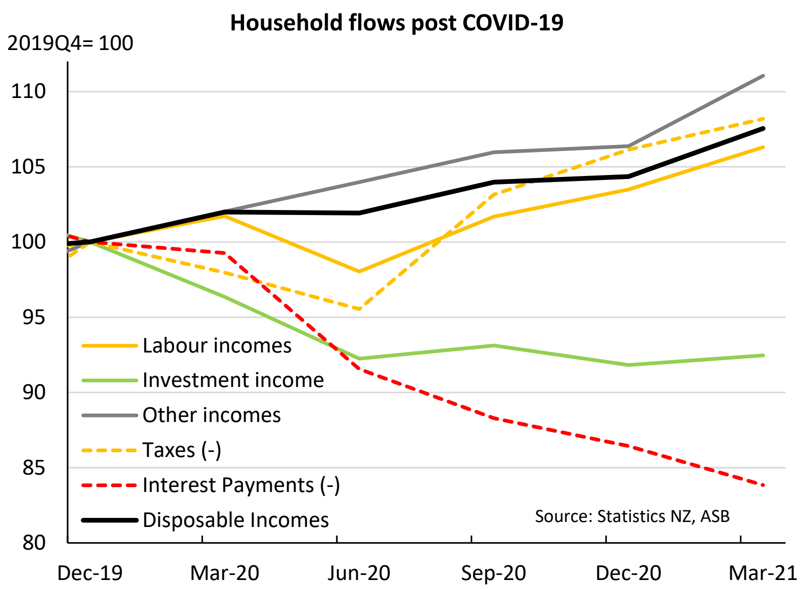
Source: RBNZ, QV, Statistics NZ, ASB

RBNZ figures point to sizeable gains in balance sheet wealth. **Our estimates suggest NZ's housing equity has increased by roughly one third (nearly $300bn) since late 2019 (close to 90% of GDP).** Our latest housing view is that there could be more upside for house prices providing the lockdown is brief. Rising housing equity has largely been driven by asset price revaluations and debt repayment by households rather than building more dwellings (see chart). **We expect gains in balance sheet wealth to continue to stick, although there is clearly some risk around this.** House prices can easily fall given stretched affordability, slowing population growth and increasingly restrictive policy actions.

Even if house prices were to fall a little, we are unlikely to see household spending weaken to a similar degree. Gains in balance sheets have been sizeable. **Moreover, households in aggregate have not cashed in this increase in wealth**, with our estimates of housing equity withdrawal (HEW) showing that more funds being injected into the housing market (via paying off mortgage principal and upgrading/building new dwellings) than are being withdrawn from it. We acknowledge that some households have cashed up and homeowners may have reduced precautionary saving buffers. This has likely contributed to the running down in aggregate housing saving from the mid-2020 lockdowns.

Household incomes and lower interest payments

Household incomes have held up well, with experimental Stats NZ figures to March 2021 showing a 7½% climb in household disposable incomes since late 2019 (see chart). Policy support played a key role, with direct transfers, the wage subsidy (which kept people employed) and the OCR cuts vital in the depths of the 2020 COVID-19 gloom.

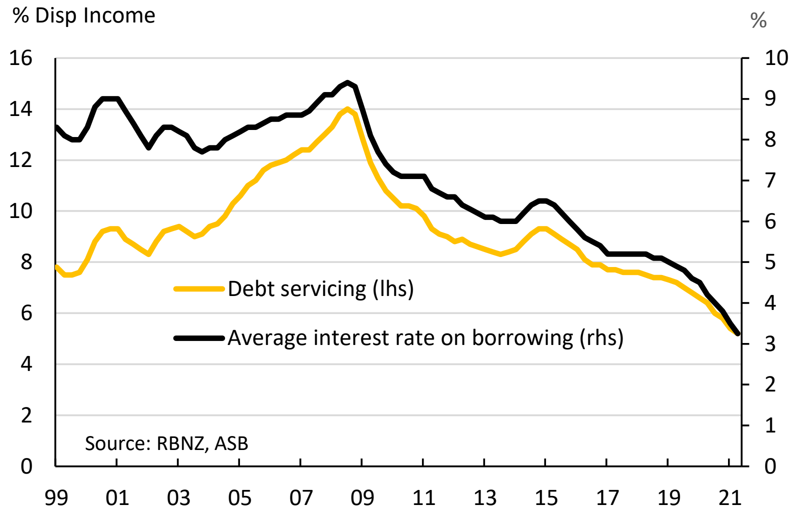


The emergency OCR cut in March 2020 also helped lower aggregate household debt servicing costs and this has boosted cashflows. Latest RBNZ figures (June) suggest actual average borrowing rates paid by homeowners have continued to decline, falling below 3% in June (see chart overleaf). This compared to an average interest rate of just over 4% prior to the lockdowns. Conversely, lower term deposit interest rates have depressed investment incomes.

The short-term outlook for household incomes is highly uncertain given the recent community outbreak of COVID-19 but we remain confident on the medium-term outlook. We have been here before and humans are remarkably adaptable when spurred into action. There are also a number of supports to household incomes, including rising wages, policy support to keep people in jobs (including the wage subsidy) and high producer incomes. We envisage that the unemployment rate will temporarily edge higher over the second half of this year, then should fall towards 4% by mid-2022.

While aggregate statistics for household spending, balance sheets and incomes depict an upbeat picture, we acknowledge that the impacts of the pandemic and actions to tackle it have been uneven and have adversely impacted some households. The rise in inflation, with annual CPI inflation set to move above 4% in the second half of this year, will further erode household purchasing power. The surge in house prices has raised the costs of getting onto the property ladder, trading up, and housing costs more generally.

Household debt servicing and borrowing costs



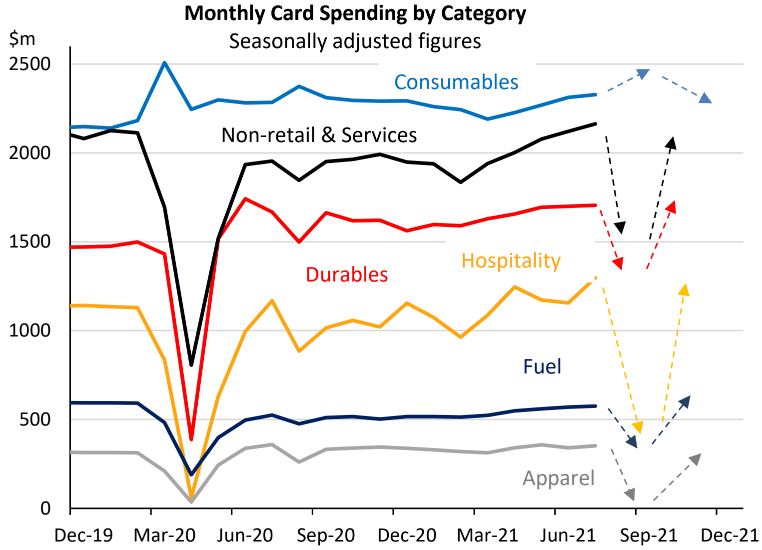
Lockdown impacts on retail spending

NZ is now back in lockdown, albeit in various degrees according to region. About one-third of the value of retail sales is 'essential retail', which can stay open irrespective of Alert Level. This includes supermarkets, grocery stores, pharmacies, and fuel retail. The lower the Alert Level, the greater the proportion of retail activity that can be accessed. Contactless delivery has helped keep much of the remainder ticking over at higher Alert Levels and couriers have been very busy.

With most households more confined to their homes, the upshot will be a hit to non-essential retail in the current lockdown. The longer the restrictions are in place, the larger the hit. In 2020 NZ spent slightly more than a month at Alert Level 4 (late March-late April), with Alert Levels subsequently scaled back to Level 1 by mid-June. It had an immediate, but thankfully, short-lived impact on retail with most forms of non-essential spending quickly bouncing back. There will, however, be sectors (most notably accommodation, hospitality and fuel sales) that will continue to struggle given the changes to retail activity wrought by the global pandemic.

Monthly Card Spending by Category

Seasonally adjusted figures



Source: Stalistics NZ, ASB

We are hoping that we see a repeat of last year, with the retail downturn proving to be short-lived and for non-essential retail set to sharply bounce back. The shift lower in Alert Levels for most of the country except Auckland is a positive for most retailers. Auckland is expected to remain in lockdown for a few weeks yet, but hopefully there is light at the end of the tunnel. With households back in the saddle, overall economic activity should strengthen, intensifying capacity pressures and prompting RBNZ hikes. **As we have been saying for a while now, households should prepare for higher borrowing costs.** Indeed, mortgage interest rates for new borrowing are off their earlier lows.

With a global pandemic swirling around nothing is certain. Still, it would be helpful for borrowers to plan for higher borrowing costs down the track. If this pandemic has taught us anything it is of the value in being prepared. In a follow-up note, we will examine the potential impact of OCR hikes on household borrowing.

ASB Economics & Research			Phone
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5957
Senior Economist	Jane Turner	jane.turner@asb.co.nz	(649) 301 5853
Senior Economist	Mike Jones	Mike.jones@asb.co.nz	(649) 301 5660
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Economist	Nat Keall	nathaniel.keall@asb.co.nz	(649) 301 5720
			@ASBMarkets