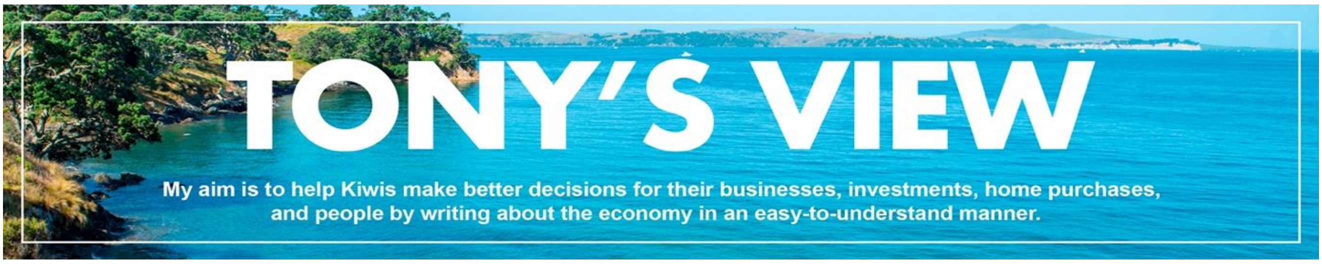

Input to your Strategy for Adapting to Challenges

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What if everyone had fixed five years?

Back from the middle of 2020 to about the middle of 2021 you could lock in a five year fixed mortgage rate at 2.99%. I jumped up and down like an idiot saying that I would gladly sacrifice the immediate cash flow benefit and skiting ability of locking in a one or two year rate below 2.5% for the certainty of a low 2.99% for five years.

I did not base my recommendation to myself on any expectation that NZ interest rates would soar. In fact I recall writing that when monetary policy tightened, we might only see the one-year fixed rate rise to just under 6%. I was out by about 1.3%.

I did not have a feeling for when interest rates would start rising or the speed with which they would go up.

All that happened is that I looked at the rate in the context of what NZ interest rates have done for the past few decades and concluded that the chances of a 2.99% rate sticking around for very long were not high. At some stage the Reserve Bank would not be fighting a fear of deflation associated with a global pandemic and interest rates would go back up to some new level of normal – not that even now we know what the new average will be for the likes of the official cash rate and fixed mortgage rates.

I also had the benefit of having been around for a while, paid 18.5% in 1987, and seen the strains which families come under when mortgage rates are pushed up to fight inflation.

In the event hardly anyone did fix five years at 2.99%. But dining out on the 2.99% call is not what this article is about. An emailer this week asked the following question. "Is it our propensity to opt for fixed mortgage rates (typically 2 years) that makes it difficult for the RB to subdue inflation quickly when it rises?"

The answer is yes. We Kiwis typically have about 80% of our mortgages at fixed rates, usually for three years or less and recently usually for either one year or two years. In Australia most people are on floating rates.

This means that the negative household effects of a rise in interest rates hit far more quickly in Australian than here. Our central bank has to wait longer before it gets to see the true impact of its policy changes. That is why their incentive is to go fast. But they did not do so in the tightening cycle which started in 2004 and for this most recent cycle which started late in 2021 they initially raised the cash rate only by 0.25% for three reviews in a row before getting serious and moving in 0.5% jumps and then a big jump in November 2022 of 0.75%.

What if the 80% or so of people who usually sit at a fixed mortgage rate did as I said I would do over 2020-21 if I had a mortgage (I did not) and fixed five years at 2.99%. Let's assume people broke their existing higher rates to lock in the best interest rate available since the 1960s and early 1970s.

All of those people would still be sitting at 2.99% now some four or three years down the track. They wouldn't be feeling any pain until mid-2025 to mid-2026. The only people who would be hit by rising interest rates associated with the inflation fight would be new borrowers and people on floating mortgage rates.

In this instance monetary policy as currently defined would be considerably weakened. The Reserve Bank would have to rely not on crunched household spending to subdue the economy and inflationary pressures, but a soaring NZ dollar boosted by the cash rate not rising to 5.5% but maybe the 8.25% of 2008 or higher.

Our export sector would have been badly affected. So, farmers, you have the short planning horisons of typical Kiwis to thank for the exchange rate this tightening cycle causing near no pain at all.

The Reserve Bank would have had to rely on the government helping out by tightening fiscal policy. That would involve cutting spending and raising taxes. One can imagine the Labour government at the time would have found cutting spending an impossible thing to do. So instead they would likely have raised taxes.

However, while they might gleefully have imposed a new extra high marginal income tax rate on upper income earners, to be effective the inflation fighting tax increases would have to have been applied to low and middle income earners. The

2023 election result would have been even more damaging for Labour than it was.

Hence a lesson for those who say inflation fighting should be done with fiscal policy instead of monetary policy via interest rate changes. No sensible government is ever going to call themselves a turkey and hop in the oven in the name of helping out the Reserve Bank.

So, what else might the Reserve Bank have done to try and exert downward pressure on the economy? To minimise the extent to which they would have to raise the cash rate and cause the NZ dollar to rise, the Reserve Bank might look at extra rules curtailing the availability of new loans for home purchases and even buying of consumer goods.

That wouldn't be hard to do. Just take the minimum deposit from 20% to 50% or more and allow only 5% of bank lending to breach that rule. The resulting decline in house prices would likely have easily exceeded the 18% we saw from the end of 2021 to mid-2023. Sharply reduced household wealth would have helped curtail spending.

The house building sector would also have been crunched because no exemptions could be provided for funding of new-builds as this would have generated unwelcome employment of people in the construction sector. At this point a fight with the government would probably have been opened up because of the impact on first home buyers.

It is likely that the net outflow of Kiwis from New Zealand this past year would have comfortably exceeded the 47,000 reported.

It would have been a mess frankly. So, while the tendency of Kiwis to fix their mortgage rates does cause lags in the impact of monetary policy tightening and loosening, at least hardly anyone paid attention to what I was writing over 2020-21 and we avoided a big problem. Well done all you people paying 6.5%+, you've helped the export sector, limited the net loss of Kiwis, and delayed the house building downturn by a couple of years.

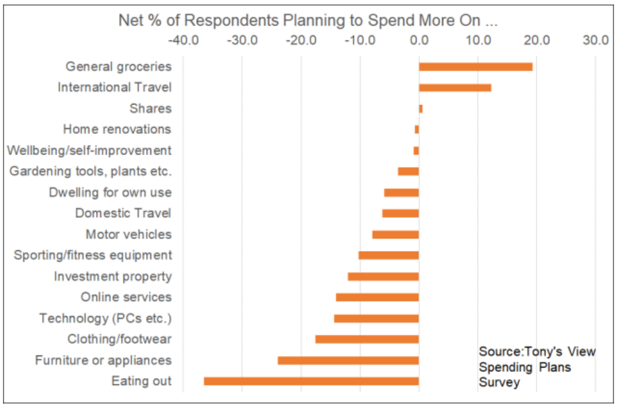
The continuing bad outlook for retailers

This week I ran my monthly Spending Plans Survey. I do this exercise in order to get a feel for whether consumers are planning to spend more or less on stuff generally in the next 3-6 months, what they plan buying more and less of, and what the motivations are behind their decisions.

Unfortunately for retailers the news remains bad. Closures which have been happening amongst retailers over the past 18 months look highly likely to continue.

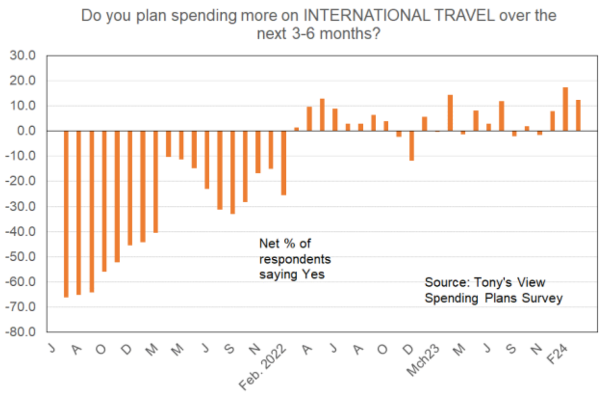
In this month's survey a net 24% of the 343 respondents said they plan cutting their spending. This is a deterioration from the net 18% of February.

The biggest area in which people plan cutting spending remains eating out followed by furniture and appliances. Increases are planned for general groceries – clearly reflecting higher prices – plus international travel.

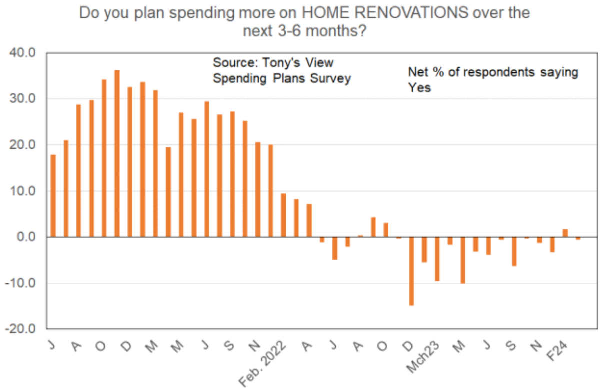


In the following graphs we can see the changes in spending plans through time for a selection of the categories listed in the preceding graph.

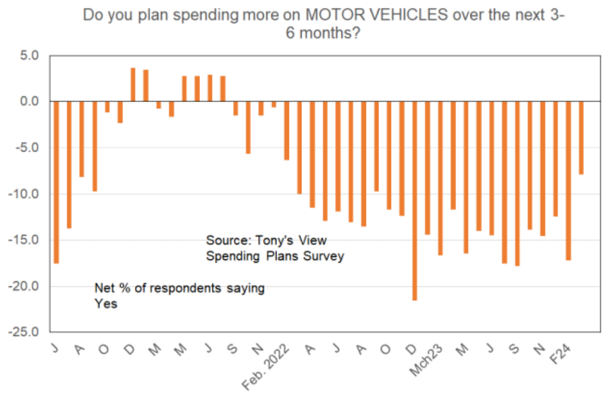
We may display high pessimism, but we are determined to travel offshore. Anyone who lived through the 1970s and 1980s would probably find this dynamic confusing.



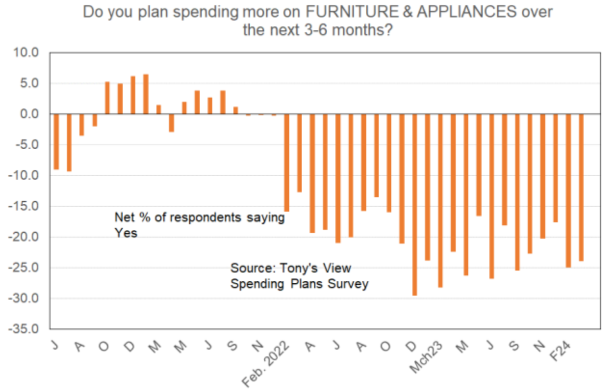
The home renovation boom induced by the pandemic ended almost two years ago and hasn't come back in these challenging times as yet.



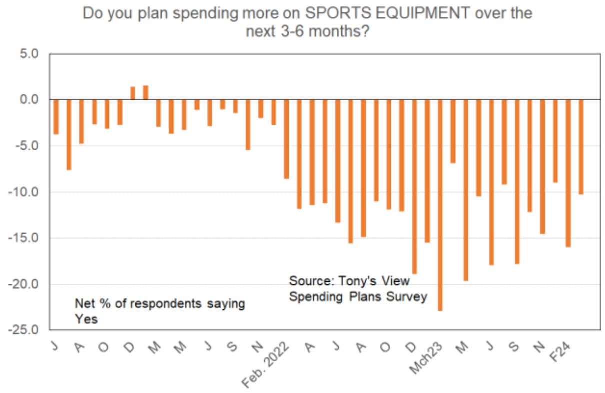
Things have actually just got a tad less bad for motor vehicles.



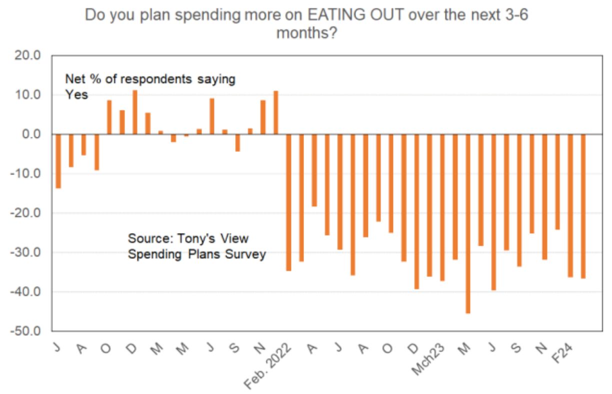
But we don't want new furniture and appliances.



Sports equipment demand remains weak.



Plans for spending on eating out collapsed two years ago and remain highly negative. Sentiment and incomed will be one factor. Soaring costs of food and drink will be another.



I will discuss outcomes for the questions about buying a dwelling to live in and an investment property next week, along with motivations behind people's spending plans.

In case you missed it

On Monday I released results from my survey of real estate agents sponsored by NZHL. The key outtakes include these.

- There has been a noticeable decline in buyer presence in the market although first home buyers remain active.
- Buyer concerns have grown about their employment, and the earlier decline in worries about interest rates has reversed in the face of discussion about monetary policy tightening again.
- Appraisal requests to agents are running at very high levels suggesting that for the moment motivated sellers are exceeding motivated buyers. As a result, FOMO levels have fallen away.

The-NZHL-Property-Report-February-2024.pdf

If I were a borrower, what would I do?

This week NZ wholesale interest rates have edged down by small amounts. Extremely high uncertainty remains regarding the speed with which the inflation rate will settle comfortably under 3%. We can expect rates to move up and down as data results come in stronger or weaker than expected. This week the very weak card spending data contributed to the lower rates.

I have a view that the Reserve Bank has over-crunched the economy and will play catch-up policy easing from late this year. So, if I were borrowing at the moment, I would probably take a mix of 6 and 12 month rates.

Nothing I write here or anywhere else in this publication is intended to be personal advice. You should discuss your financing options with a professional.