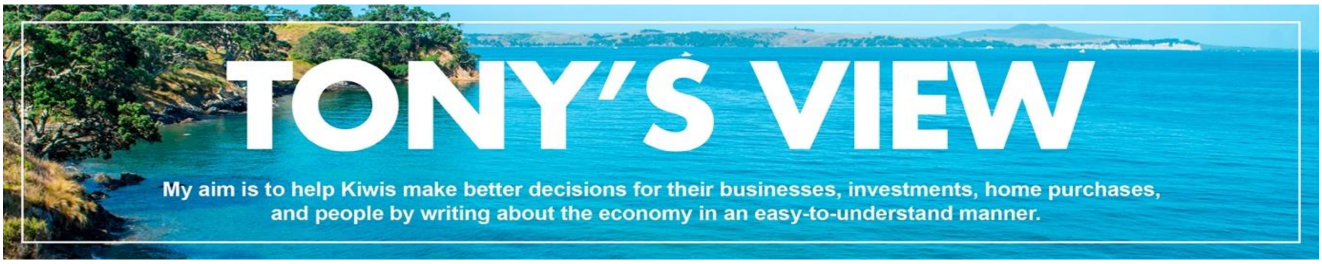

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Thursday 15 December 2022

Looking back at 2022

This is my last issue of Tview Premium (and Tony's View) for the year so let's have a look back at what I was thinking when the year started and how things have turned out.

First, and mainly to put the boot in to the tall poppy cutters out there – if you'd paid attention to what I was writing in the second half of 2020 and first three quarters of 2021 and locked in your mortgage rate fixed for five years at the 2.99% - 3.99% prevailing then you'd be sleeping easy now. But most people took the candy of 2.19% fixed for one year and now are paying the price as they roll onto 6.5% or thereabouts.

As a rule, ever since fixed interest rates appeared in the early 1990s we Kiwis have opted for whichever rate is the lowest. But we also only rarely have fixed beyond three years, so it was never likely that many people would fix five years at 2.99%. Thanks to those who did who have emailed me their appreciation for highlighting how ridiculously low the rate was in the context of where mortgage rates normally sit in New Zealand.

At the time when I was jumping up and down pointing out how attractive the rate was, I did not have a firm view on how rapidly interest rates would rise or where they would peak. Every monetary policy tightening period is experimental and you never know exactly what the impact of interest rate rises will be on the exchange rate, business willingness to hire people, consumer spending, and the housing market. And this time around the degree of experimentation has been the greatest we have ever seen. Not only are current outcomes being affected by the waves created by deflation worries in 2019 (remember all the talk about negative bank deposit rates) and a global pandemic, but this is the first tightening period of reasonable duration since before the Global Financial Crisis.

Thus, much as we economists do like to be pricks and stick the boot into the RBNZ (which makes itself such an easy target these days through the personalities involved, over-adherence to failed mathematical models, and focus on non-monetary things), none of us have got our outlooks right.

At the start of the year I wrote about an expectation that the cash rate would rise from the then 0.75% to about 2.5% with the one-year fixed mortgage rate hitting 4.5% - 5.0%. The financial markets were pricing in a rate of 2.25% come December 2022. Instead, the cash rate is now 4.25% and the one year mortgage rate about 6.5%.

Why are these rates higher than we all guessed? The unexpected Russian invasion of Ukraine has pushed up energy and food prices around the world. Extreme supply chain problems exacerbated by China's refusal to use modern vaccines and pursuit of a failed eradication policy for too long have pushed up materials prices. Unusually fast wages growth in New Zealand, and greater shortages of capacity than expected overall in the NZ economy have played a role.

Nonetheless, looking back at my first writings of the year I remain happy with my comment that if I were a borrower I would then have been happy fixing for either two or three years at the rates prevailing of about 4.15% and 4.69% respectively.

What about the housing market? I expected it to flatten out but definitely did not expect prices to fall as much as they have. Why the forecasting error? Interest rates have gone higher than expected, under-estimation of the impact of the tightening of LVRs and CCCFA changes, and one other thing.

House prices reached absurdly high levels late in 2022 despite what in the second half of last year were rising interest rates, worsening migration flows, and tightening credit availability. Things simply got too far beyond reality and the whipping back the other way for this year was, like the unusual surge in prices over 2021 H2, greater than any of us anticipated.

I have been warning about a widespread weeding out of businesses in the residential building sector since early-2021 but did not expect that it would take until now for the pullback in activity to really get underway. Just as prices reached strained levels so too has the level of construction and the number of consents being issued for new dwellings. Those consent numbers are only now falling off – but largely for houses and not yet for townhouses.

There is a lot of weakness to come in the townhouse building sector and summer is going to bring many examples of building companies going under and projects being left half-completed with people losing their money. Like excessively high inflation, and a boom/bust cycle in house prices, this is another way in which the Reserve Bank has worsened stability in our economy. They seem to have become a net negative for the country.

I can't recall giving any strong view on the currency but do think I mentioned to some people an expectation that the tightening of monetary policy in NZ and good export prices would see the NZ dollar go up. Instead, we lost ground against the US dollar from 68 cents at the start of the year to 56 cents in October. Thankfully I gave up currency forecasting 2-3 decades ago and have repeatedly stressed that I don't have the foggiest where the NZD will go – just proven again.

With regard to the labour market, at the start of the year I wrote about business problems finding staff getting worse and that has certainly turned out to be the case. In January I noted the high 28% of businesses in the NZIER's Quarterly Survey of Business Opinion who said labour was the main reason they could not increase output. That proportion is now a record 42%.

I noted that the pace of growth in wage and non-wage labour costs would rise and that has certainly happened. Average hourly ordinary time earnings in the private sector have gone up by 8.6% in the past year through wage rate rises and people shifting to higher paying jobs. That is the churn I strongly warned about as staff discovered the reluctance of employers to pay higher wages meant their best bet to beat the rising cost of living would be to shift jobs. There is more of that to come through 2023.

Retailing has held up better in recent months than I expected, with my views mainly shifting to the negative upon receiving the first results of my monthly Spending Plans Surveys for 2022. They showed a clear decline in spending intentions which have now become much worse. It looks like the crunch in consumer spending has merely been delayed, not avoided. This is a sector which has already had turbulent times because of the pandemic and the coming year will see more operators close down.

Those who are well capitalised with good products and service will be able to continue to snap up prime locations as we have already been seeing. In the likes of crime-ridden Auckland (plus Wellington and Christchurch) this means staking a location claim and being able to wait for things to improve.

What are my expectations for the coming year? I will make that the subject of my first publications for the year on January 12. But suffice to say for now it seems reasonable to expect the following.

- Falling consumer spending for the first half of the year and retail business failures.
- House prices edging lower until the middle of the year.
- Fixed mortgage rates for periods beyond one year falling before the middle of the year.
- House construction embarking on a 2-3 year period of decline.

- Falling numbers of properties listed for sale.
- Firm net migration inflows.
- A probable change in government late in the year.
- The Kiwi dollar either rising or falling against the currency of your choice – or the other way around.

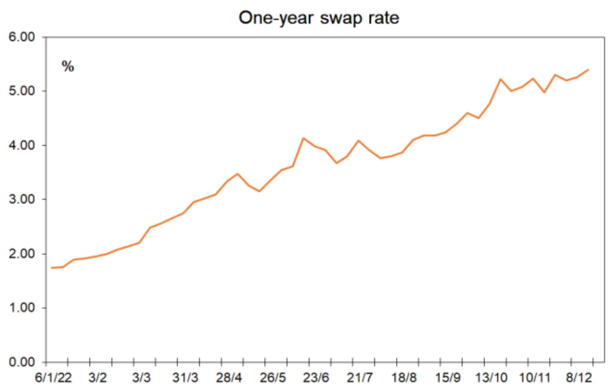
I hope everyone gets to enjoy Christmas and Summer to a good degree. Many thanks to the thousands who have replied to my monthly survey requests during the year. Next year I will be bringing back my Business Survey which gives insight into coalface developments across many sectors in the economy. If anyone wants to sponsor it let me know.

If I were a borrower, what would I do?

The next few months are likely to produce some big ups and downs in wholesale interest rates from one week to the other. The strong focus of market participants now is on whether signs of monetary policy working are showing through and whether they are strong enough to allow a solid calling of where cash rates peak and when here and offshore. Then attention will turn to when rates fall and how quickly.

The environment is going to be one of high instability and borrowers need to be careful not to get overly fixated on what the general themes are from one week to the other. It is best just to remember that monetary policies here and offshore are guaranteed to get inflation down eventually but if you are heavily exposed to short-term rates as we head into the peaks you run the risk of panicking and locking in for a long-term fixed rate at the worst time in the cycle for doing so.

During the week here in NZ the one-year swap rate which banks pay to borrow funds for lending to you and I at a fixed rate for one year climbed to just about 5.4%% from just over 5.2% last week. The three year rate climbed to about 4.95% from 4.7%.



The rise in rates was partly due to this morning's much stronger than expected GDP data which showed output grew by 2% in the September quarter rather than the less than 1% rise which the markets had been primed for. The outcome bespeaks of greater pressures on capacity than assumed and therefore stronger underlying inflationary pressures than built into current monetary policy outlooks. The Reserve Bank had estimated the rise in GDP to be 0.8%.

The numbers however are out of date and won't likely much influence current Reserve Bank thinking.

If I were a borrower, what would I do?

I'd fix for 1-2 years. Three years feels too long given the likely easing in monetary policy over 2024 and 2025.

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.