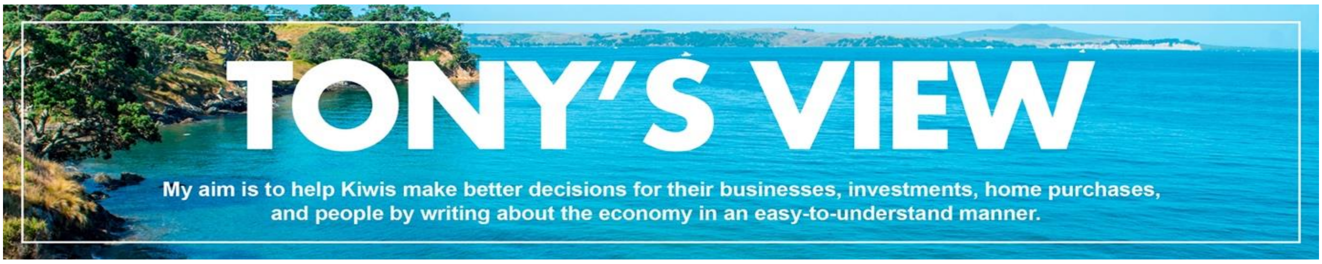

Input to your Strategy for Adapting to Challenges

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Seeing through the wool

My headline articles in the past two weeks have dealt with the issue of low wages growth in New Zealand and some employers thinking they can continue to get away with it. Many probably will – but the outcome will be many young Kiwis burdened with student debt, facing high house prices and high prices for groceries and appliances, leaving our shores as has happened many times in the past.

People do not need to stay in New Zealand earning low wages in order to enjoy great mountain biking tracks within just a few minutes of your CBD workplace (Wellington).

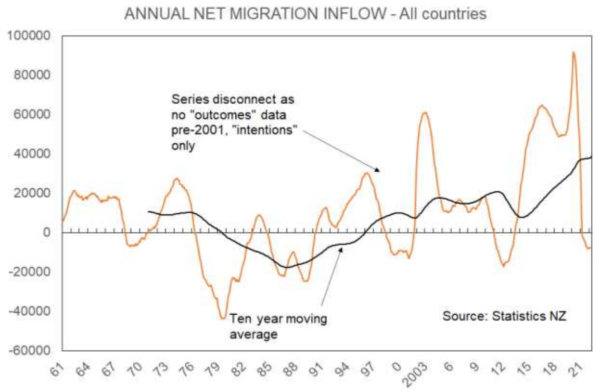
You do not need to stay in New Zealand to be able to swim in the sea and lie on a golden beach after work – as in Auckland, Nelson, and Dunedin to name a few places.

You don't need to stay in New Zealand to enjoy great mountain walking. There are other countries which also have mountains with snow on them. Lots of young Kiwis work on them.

You don't need to stay in New Zealand to grow or enjoy organic food. Actually, we've got a couple of centuries of heavily sprayed land under our feet.

And the media focus on how the poor underbelly is growing, and that there are crises in an increasing number of areas. Housing, rental property, child poverty, health, education, mental health, infrastructure, biodiversity, cost of living, food supply, wealth distribution, etc.

We've had a great run economically since the necessary reforms of the 1980s, and upwardly trending net migration inflows probably reflect this situation. This trend is shown by the black line in the following graph.



But just as interest rates have spent the past three decades falling and now will edge higher, it feels like the net migration flows will also now trend back the other way.

You don't need to leave New Zealand in order to have a wonderful life. If you are prepared to sacrifice income then you can enjoy a lifestyle which you will be able to tell yourself the rest of the world envies. Which is a key part of our problem.

The people you are surrounded by in New Zealand have either never had the get up and go to get out, or they have left but come back for lifestyle (not income) reasons but with a nest-egg. Or they are migrants wanting to live a life different from the often crowded situation they came from – especially after the migration rules changed in the late-1980s and source country became almost irrelevant.

You are surrounded by people whispering in your ear how great it is to be here in Godzone. And it is – if you've got the money to afford it or you've come from a hellhole.

Migration flows move through cycles, and we are entering a period of sustained net losses which will involve intense talk of a brain drain. This will dent confidence in the economy and help place a cap on how high interest rates need to go in order to crack household spending and suppress business pricing power.

The talk will reveal weakness in the argument that we have housing shortages (outside low-end property and social housing) in most parts of the country. House construction as a result will start falling next year and the discounting by developers of some new offerings discussed just yesterday in the media is just one sign of the development boom having already ended.

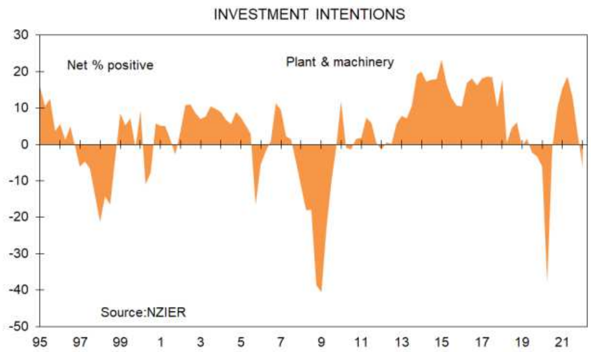
Do these things mean that our economic outlook is poor? No. The primary sector is well supported by high export prices. The government's accounts are in good shape and after the fiscal stimulus planned for May 19 there is likely to be another one come next year's pre-election Budget and probably something in between the Budgets as well given the readings in the polls.

Job security is very high (a very different situation from past periods of brain drain). There is a lot of infrastructure to be built. The international tourism sector is to reopen and from next year foreign students are likely to be back in good numbers.

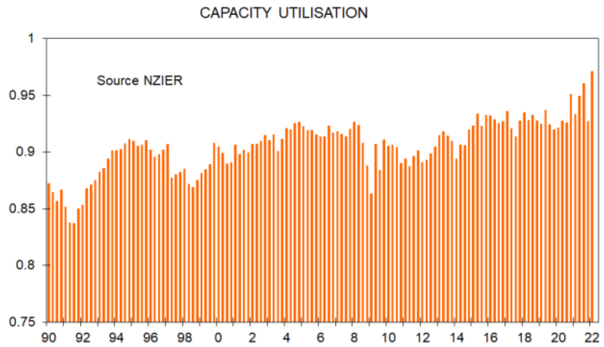
Business capital spending levels are likely to rise simply because they will have to in a world of ongoing labour shortages.

But let's take a look at such prospects in light of the NZIER's Quarterly Survey of Business Opinion released just ahead of Easter.

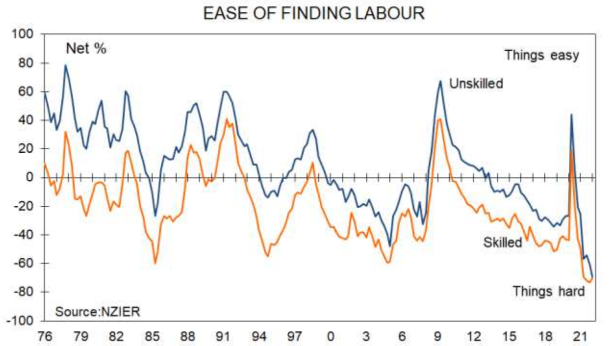
Their very long-running survey revealed a fall in business investment intentions in plant and machinery to a net 6% negative from 3% positive in the previous quarter and 13% positive six months ago. As the following graph shows, this is not a serious deterioration and perhaps the best interpretation is that the previously anticipated recovery in capex is going to be slightly delayed. That would make sense in light of the uncertainties introduced by Russia's war against Ukraine and China's failed Covid strategy which is newly disrupting supply chains.



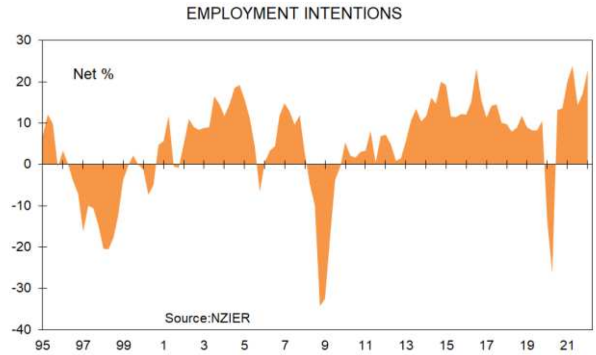
Just for the record, here are some of the other key results from the NZIER survey. The capacity utilisation rate in the manufacturing and building sectors hit a record high just above 97% last quarter. Pressure to boost capacity is more intense than it has ever been.



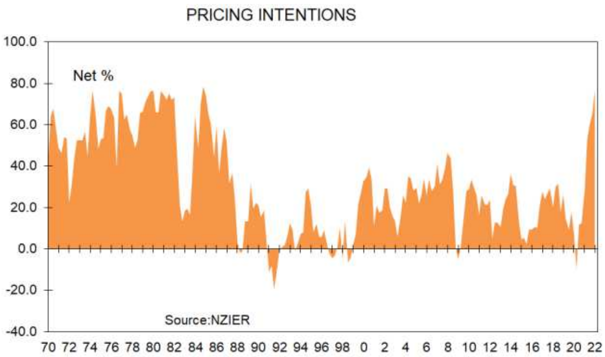
Firms are having record difficulties finding unskilled labour and near record problems getting skilled people.



A near record net 23% of businesses plan hiring more people – or at least trying to.



A net 77% of businesses expect to raise their selling prices in the next 12 months with a net 56% having seen their costs just go up.



If I were a borrower, what would I do?

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.

Rates creep higher

During the week the Reserve Bank Governor noted that central banks "…are going to need support" to get inflation under control. This is a polite version of the comment I noted last year would be made sometime this year - "Monetary policy needs friends."

This refers to the problem created by governments loosening fiscal policy to try and offset some of the effects of higher interest rates on household budgets. Their actions are explicitly aimed at weakening monetary policy effectiveness and therefore force the central bank to raise interest rates higher than would otherwise be the case.

The NZ government is already planning to throw $6bn around to all and sundry they deem deserving of it in this year's Budget a month from now. It is also likely that in the 2023 Budget they will open up the spigots for two reasons. First, the fiscal accounts will almost certainly continue to surprise on the positive side.

Already this year the deficit is $4bn smaller than Treasury predicted and there is zero pressure on the NZ government from offshore to reduce the deficit more quickly than currently planned or cut debt levels. The situations offshore are far worse.

Second, the opinion polls suggest the election will be a lot closer than looked like being the case up until a few months ago and it would defy logic for a government losing popularity and under no fiscal pressure to rein in spending in an election year.

However, there are two objections to an argument that upside risks for mortgage rates abound.

The first is that we can already see evidence of consumer spending being crunched and as the discussion about loss of people to Australia grows and house prices fall further while some smaller inexperienced developers fall over, generalised spending is likely to be further weakened.

Second, in a capacity-constrained economy as we have now, the ability of the government to actually spend the extra money it wants to is not high. Basically, unless they simply legislate for higher direct handouts, a lot of planned spending in areas of health, housing, etc. will be unable to proceed because they will not be able to find the staff to do the work.

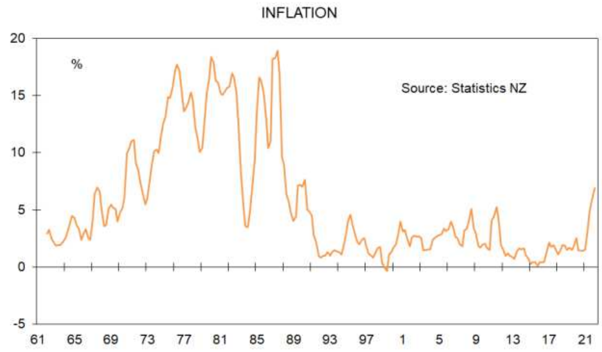
This is one reason why the fiscal position is better than expected.

My view therefore continues to remain unchanged from a year ago. The peak in the official cash rate is likely to be 3.0%. If I change that view it is more likely to be a reduction than an increase.

As for the wholesale markets this past week. Interest rates relevant to the cost of money banks borrow to lend to you for a mortgage have risen on the back largely of higher interest rates in the United States.

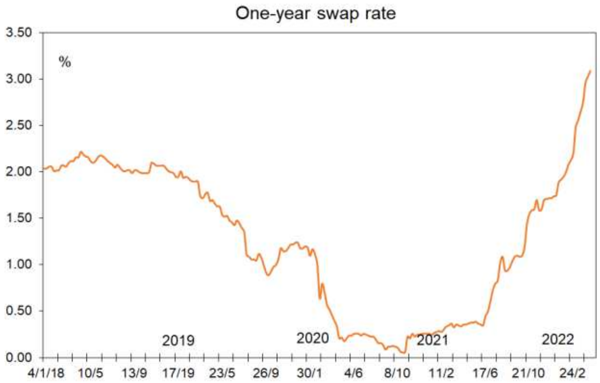
Across the Pacific analysts have become more convinced that the Federal Reserve Board will kick off the policy tightening cycle with a 0.5% rise, following on from such rises in New Zealand and Canada.

The 10.45am release today of the Consumers Price Index data for the March quarter largely met expectations. Due substantially to events overseas but also with rising housing rents the CPI rose in the quarter by 1.8% and over the year by 6.9%.



Although this was slightly less than the 7.1% expected on average the difference is not great enough to alter expectations that the Reserve Bank will continue to tighten monetary policy at pace in coming months.

The base cost to NZ banks of borrowing money at a fixed rate for one year (swap rate) to lend it at a fixed rate for one year has edged up closer to 3.1% from near 3.05% last week and 2.65% four weeks ago. The three year swap rate is now around 3.75% from about the same last week and 3.3% four weeks back.



My current expectation for the one-year fixed mortgage rate in April each year is shown in the first column of the table below. I focus on that rate because there are many people who have fixed one-year repeatedly since 2009 and the strategy has worked very well.

The second column shows what the one-year rate will average over the next 2-, 3-, 4-, and 5-year periods. The last column shows the current best 2 – 5-year fixed rates charged by the lenders I track.

	Forecast 1 year rate	Rolling average rates	Current fixed	
2022	4.19		4.19	1 yr
2023	5.00	4.60	4.85	2 yr
2024	5.25	4.81	4.99	3 yr
2025	4.25	4.67	5.45	4 yr
2026	4.00	4.54	5.69	5 yr

If these forecasts prove correct (I'd give that a 10% probability), rolling one-year fixed will deliver an average rate for the next two years of 4.60%, three years 4.81%, four years 4.67%, and five years 4.54%.

If I were a borrower, what would I do?

Personally, I wouldn't fix longer than two years.

To see the interest rates currently charged by major lenders go to www.mortgages.co.nz

In Tview Premium each week

1. I include deeper discussion about rate changes and the factors driving where borrowing costs will go.
2. I also present graphs showing levels of fixed mortgage rates over the past three decades so that latest changes can be put into perspective.
3. I also print graphs showing bank lending margins on fixed rate mortgages so one can get a feeling for the direction in which rate pressures lie and by how much mortgage rates could change even without any alteration in financial market/monetary policy pricing.

There's a bit of spare space here this week, so here's a graph showing margins between the two year swap rate and the best two year fixed mortgage rate offered by the five main lenders I track. The margin remains decidedly below average and scope for further increases remains.

Links to publications

Tony's View Spending Plans Survey

Spending Plans Survey

Tony's View Business Survey

Business Survey

Tony's Thoughts Vlog

NZHL HOME LOANS | INSURANCE

REINZ & Tony Alexander Real Estate Survey

REINZ REAL ESTATE INSTITUTE OF NEW ZEALAND

Oneroof weekly column

OneRoof

[Handling high interest rates]

[Handling staff shortages]

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Tony Alexander Regional Property Report

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