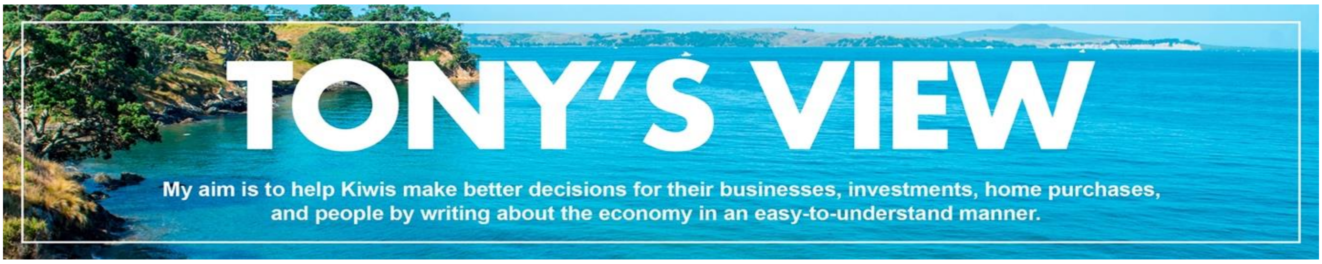

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The necessity of faster wages growth – pity about the timing

I'm going to take the opportunity created by debate about the government's legislation to introduce Fair Pay agreements to repeat something I have been stating since about 2005. A key development New Zealand needs if we are to raise our income per capita is a rapid acceleration in the pace of wage rises.

There are many businesses in New Zealand which only exist because their staff are paid very low wages. Other firms are desperate for staff and able to pay higher remuneration but we have not seen sufficient movement of people from low-paying jobs to these higher-paying ones. Why might that be?

Ever since 2008 we have seen new uncertainty in our economy and in the minds of employees associated with shocks such as the Global Financial Crisis, the Canterbury earthquake, deflation worries, and more recently the pandemic and now inflation worries. Perpetually in the media people are bombarded with the most negative scenarios for the economy, our society, our climate, the healthcare system, Covid, the education system, housing, roading, incomes, interest rates, and so on.

The word "crisis" is used frequently to describe stresses in many areas and the impression given is that most things in New Zealand are failing. In such a deteriorating and unbalanced media environment it is unsurprising that we should be talking about a surge in population outflow to Australia. It is also unsurprising that people feel cautious in their actions and become reluctant to introduce more stress into their lives by changing jobs or upsetting the boss with a demand for higher wages.

There has been a long-running under-current of feeling that it might be a good idea not to rock the boat too much and demand a decent wage rise in case one's bluff is called and a person ends up last-on-first-off at the new firm in the event of a new economic downturn. Plus, we Kiwis don't like anyone thinking that we are up ourselves. We worry that if we demand extra pay from the boss or we're out of there that they will think we are up ourselves.

There is also the issue of getting comfortable with one's arrangements for childcare, commuting, etc. in one's job and not wanting the hassle of sorting out new things in the event of shifting to a new firm.

But what we need in our country is a reallocation of people to higher paying, higher profit jobs. That requires that the inefficient firms unable to pay decent wages go out of business. Enforced higher wage and non-wage costs are a way of doing that.

It's called "creative destructionalism" and it lies at the very core of capitalism. We need more businesses to fail – not because of an economic downturn but because they don't produce a product or service valued enough by consumers to be able to pay high wages.

Yes, it is bad news for many businesses when their costs rise. But labour is in very short supply and it needs to go to profitable firms which can afford the higher costs. Some firms have attempted to avoid higher wages by bringing in cheap, or more accurately, compliant foreign labour. This helps suppress wages growth and also extends the period during which firms do not make the hard decision to boost output per employee through deeper investment in the likes of their systems, equipment, and their people.

Such investment is commonly associated with mid-growth phases of newly growing businesses and not so much the older businesses which have switched to cost-control as a means of staying afloat.

There is however a problem with this model of standard of living growth through enhanced natural attrition of businesses. The timing right now is not so great.

The Reserve Bank will likely have placed a tick in the box of one key thing it needs to see in order to be confident that inflation will get back under control – reduced consumer confidence and spending. And they'll probably be taking all inflation expectations and pricing intentions measures with a grain of salt because of the shock of the hike in living costs for the moment associated with supply chain, Covid, and war factors.

But what they will be paying close attention to is measures of changes in wages. If they see wages growth lifting sharply but do not see a decent rise in business failures or a sharp lift in business capital spending as well, then they will likely conclude that second round effects of the inflation surge are underway.

That means they will bias their commentary more to the side of warning about the need to create a recession, and probably lift their cash rate predictions.

Given that wages rise with a lag to higher living costs and labour market tightening, we are going to be stuck with RB worries about wages growth well through 2023. The RB know this lagged dynamic and will be cautious about getting too hawkish too late in the inflation cycle. That means they will be looking for indications of some decent labour reallocation away from failing firms, alongside a decent lift in business investment.

On another labour market issue there is this. We have had pretty good growth in the New Zealand economy since 1992. The unemployment rate hit 3.4% in 2007 and is now 3.2%. Yet we still see poor outcomes in terms of health, education, housing, training, income, and workforce connectivity for entire segments of our population.

It is easy to see how a government would conclude that a deregulated economy with a well deregulated labour market is not producing the sort of outcomes for our society that 99% of us want. On that basis, it is not surprising that the government is opting for measures other than the free market to help deliver desired outcomes in the medium to long-term.

Those measures include cutting back on business access to cheap foreign labour and forcing businesses to pay their staff more at the lower end of the wage spectrum.

This is a fairly tough environment for businesses which will get a lot tougher if Labour win the late-2023 general election. It is always best to try and get ahead of the curve for things which are happening and for businesses this means things such as the following.

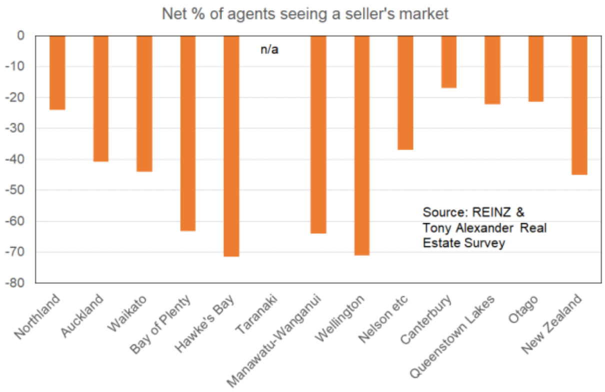
If you cannot afford another hike in the minimum wage, close down now. If you cannot afford extra imposts associated with paid leave and a new holiday, close down now. If you are losing staff generally and cannot afford higher wages on average to get new ones or retain existing people, either close down or boost your labour productivity.

That may mean new systems, location, whatever. At a minimum it means getting external help if necessary to help you figure out where exactly your best profit comes from. You may need to stop trying to grow your customer base and your product range and instead concentrate on the highest yielding locations, products, production and distribution methods, and so on.

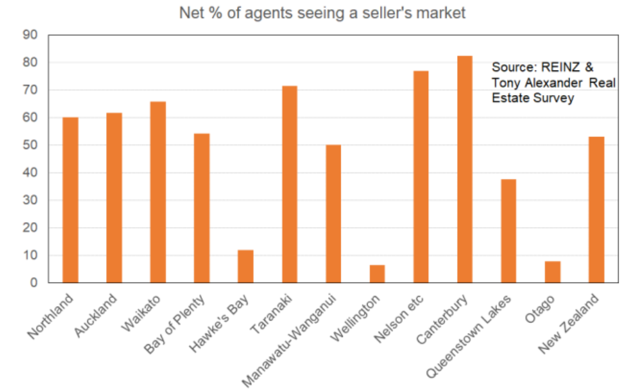
Running a business is never easy. We are in a sink or swim environment. If you're going under, the sooner you jump out of the pool the better for you, your family, and probably your staff.

Buyers hold the power

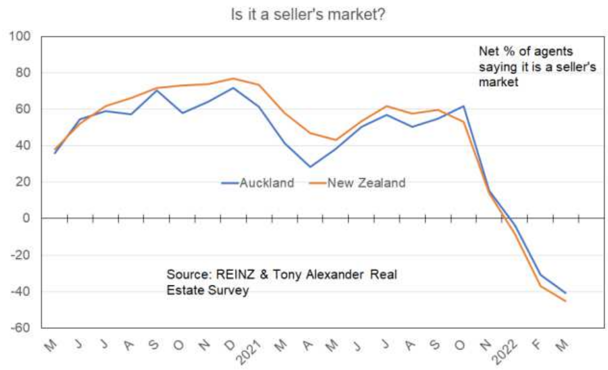
From my monthly survey of real estate agents with REINZ we can get a clear indication as to which parts of the country have shifted from being a seller's market to a buyer's market – one in which buyers hold the upper hand. Buyer's have the upper hand everywhere, and especially so in Hawke's Bay, Manawatu-Wanganui, and Wellington. Not so much in Canterbury.



Compare this current situation with how things looked back in October.



The turnaround in who holds the power in negotiations has been rapid. This final graph shows the change over time for Auckland. In Tview Premium I have graphs also for Wellington and Canterbury.

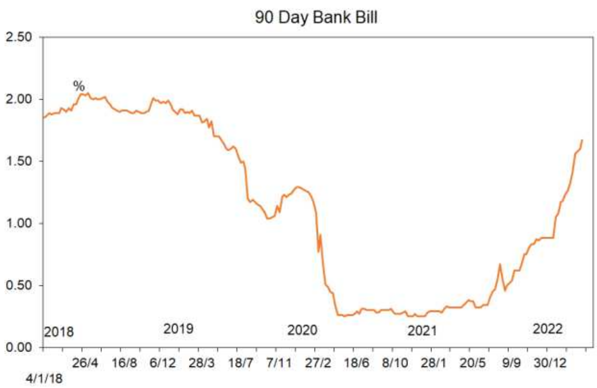


If I were a borrower, what would I do?

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.

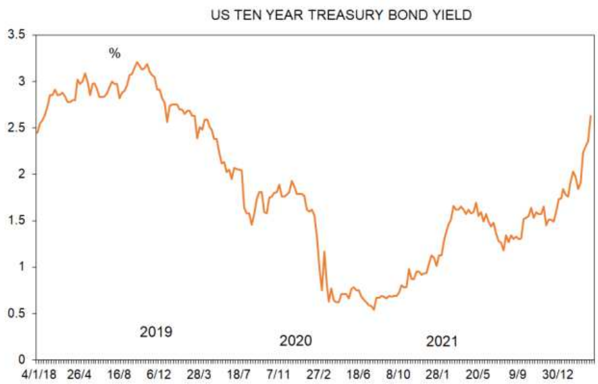
Rates rising globally

In anticipation of a monetary policy tightening here next week and reflecting higher rates around the world, this week we have seen the yield on 90-day bank bills which form the base from which banks set their floating mortgage rates rise to around 1.67% from 1.6% last week and 1.3% five weeks ago.



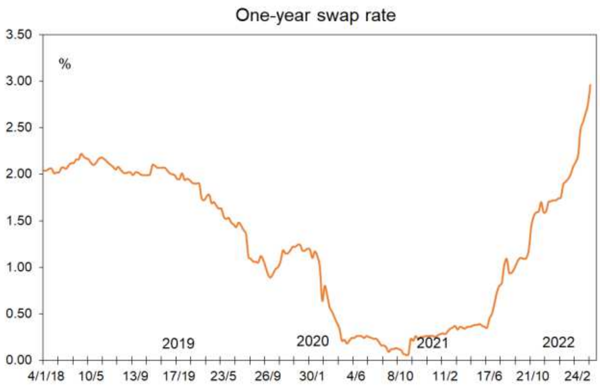
The more interesting moves however have been for the swap rates which form the bases from

which banks calculate their cost of funds for lending to you and me at a fixed rate for our mortgages. There has been a substantial selloff in United States bonds this week which has taken the yield on the ten year US Treasury to 2.63% from 2.36% last week and 1.84% five weeks ago.



The selloff mainly reflects rising expectations of rapid 0.5% at a time increases by the Fed. in its funds rate. But there is also upward pressure from comments suggesting rapid selling of the Fed's holdings of bonds bought in their money printing exercises over the past few years.

The upshot is a lift in medium to long-term bond yields all around the world including here. For the swap rates we have seen the one year term in NZ rise to a rate of 2.96% from 2.75% last week and 1.7% at the start of the year.



The three year swap rate has risen to 3.66% from 3.41% last week and 2.45% at the start of the year.

There is now intense pressure on banks to increase their fixed mortgage rates and the graphs I include each week in Tview Premium showing where bank margins on such lending sit versus average can allow insight into how big the coming increases might be.

With regard to the future, 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 minimum 2 – 5-year fixed rates charged by the lenders I track. This week I have excluded Westpac's rates as of this morning because they are well out of line with other lenders and clearly set to be hiked substantially just to catch up.

	Forecast 1 year rate	Rolling average rates	Current fixed
2022	3.99		3.99
2023	5.00	4.50	4.69
2024	5.25	4.75	4.99
2025	4.25	4.62	5.45
2026	4.00	4.50	5.79

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 4.50%, three years 4.75%, four years 4.62%, and five years 4.50%.

If I were a borrower, what would I do?

I might still fix two or three years for the rate certainty delivered. But the cost of such certainty for longer than that is too high compared with what I think monetary policy and therefore one year fixed rates will do over the next few 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.

Links to publications

Tony's View Spending Plans Survey

Tony's View Business Survey

Tony's Thoughts Vlog

REINZ & Tony Alexander Real Estate Survey

Oneroof weekly column

[Handling high interest rates]

[Handling staff shortages]

[Handling high cost of living]

mortgages.co.nz & Tony Alexander Mortgage Advisors Survey

Tony Alexander Regional Property Report

Crockers & Tony Alexander Investor Insights

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