TONY'S VIEW

Input to your Strategy for Adapting to Challenges

Feel free to pass on to friends and clients wanting independent economic commentary

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My Aim

To help Kiwis make better decisions for their businesses, investments, home purchases, and people by writing about the economy in an easy-to-understand manner.

You snooze, you lose

If you have held off fixing a goodly portion of your debt at a fixed rate for a long term, then these are the assumptions you have been making.

1. That the surge in materials costs around the world will reverse once supply chains get back to normal.
2. That central banks hold steadfast in their stated belief that the price shocks of supply chain disruptions will be temporary.
3. That businesses recognise cost increases are temporary so do not increase their selling prices.
4. That the biggest fiscal and monetary policy stimulus packages you have ever seen will not cause a rise in the pace of inflation.
5. That the worsening shortages of labour around the world and in New Zealand will not produce an acceleration in the pace of wages growth.

Or you just take whatever the lowest rate on offer is – the same as most borrowers.

Chances are that you might be able to feel some comfort with the first three factors above. But on the last two you may waver. How realistic is it to expect that printing money and running huge deficits will not lift inflation? And how realistic is it to expect that people will not ask for, or shift employer for, higher wages when the shortage of employees is becoming so well known? It's a high-risk gamble.

It is certainly possible that the increase in inflation rates to the likes of 9% for China's factory gate measure and 5% for consumer goods in the United States will be temporary. But how much are you willing to bet on that? Your house?

That is what you are risking if our central bank enters "once more unto the breach" and attacks accelerating inflation in the only way they ultimately know how. By rapidly raising interest rates and if necessary, causing a recession.

The risk is this. At some point the dam breaks and central banks globally indicate that their confidence about the rise in inflation being only temporary is fading and they suggest rates might rise as early as next year – which they probably will. In fact, last night the Federal Reserve in the United States published a graph showing they expect two rate rises in 2023, not 2024. This has produced some rises in global fixed interest rates which will filter through here as well.

Experience yields some insights which can be useful and having been in this business since returning to New Zealand from Sydney just before the sharemarket and property market crashes of 1987, then the Mother of all Budgets in 1991, I can attest to the following.

When inflation risks rise, we economists have a 90% tendency to downplay the risks. We say that this time things will be different and interest rates will not have to go back to the levels they were at in the past. We will invariably cite higher ratios of household debt to income – just as we can do now.

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But we tend to be wrong a lot of the time, and ahead of the GFC we repeatedly under-estimated how high interest rates would need to go. After the GFC we consistently over-estimated the levels they would need to go to.

It's a 50:50 call which way we will be wrong this time around. But my money is on the markets under-estimating how high interest rates will need to go to resecure low inflation. That's why as soon as the 2.99% five-year fixed mortgage rate appeared, and through the entire time it was offered, I said it would be good enough for me to fix 100% of my mortgage if I had one.

Economics has a nasty habit of biting you in the backside, even if it might take seven decades in the case of the Soviet Union. The demand and supply curves always win in the end and when it comes to inflation risks and the implications for borrowing costs, as each month goes by the odds fall increasingly in favour of monetary policy having to engage in a period of catch-up tightening to prevent a repeat of the 1980s experience.

One key to it all is this. Our central banks have been given goals beyond just targeting low inflation. They are now charged with pursuing low unemployment and other goals as politicians have reasserted their authority over these independent institutions. But the greater the reassertion of power the greater the blowback will be in the form of the central banks having no choice other than to revert to form and doing what they do best – which is not promoting inclusiveness and self-proclaiming themselves equivalent to a respected tree.

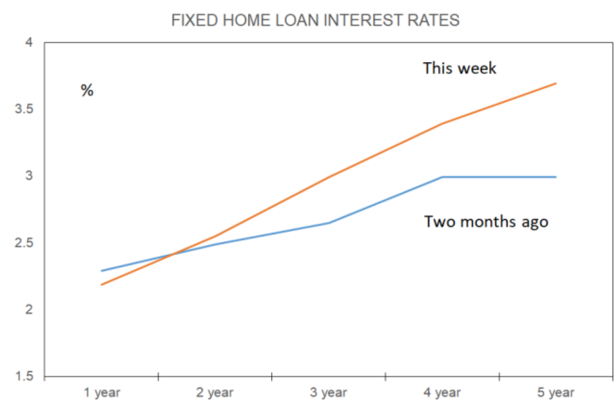
(For your guide, one reason NZ interest rates are so low and have caused house prices to soar 30% is the government requiring the RB to target low unemployment. An own goal.)

Ultimately, central banks are the scorpion riding the head of the fox across the river. They will sting. Its in their nature.

So, let's go back to the most popular section of the weekly commentary which I wrote while collecting a salary.

If I were a borrower, what would I do?

Personally, I'd already be fixed five years at 2.99% and sleeping easy as the five-year rate now sits 0.7% higher and inflation worries rise globally. But if I personally were facing the decision today the choice would be more difficult. The lowest five-year rate now on offer by the lenders I track is now 3.69%.



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The graph just above shows how fixed mortgage rates have changed in the past two months.

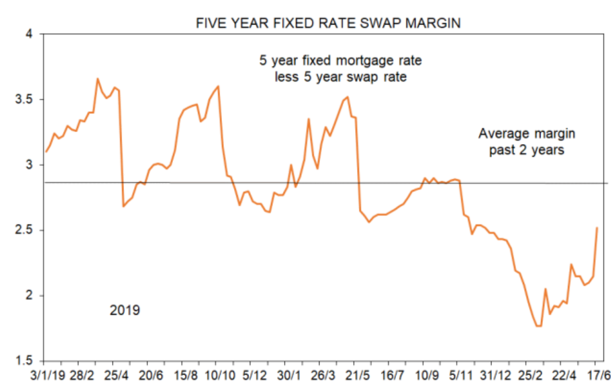
I discuss the situation in depth with consideration of a number of alternatives in Tview Premium. But in summary, for this week, I am running on the following forecasts of where the one-year fixed mortgage rate will sit for the periods shown. Each week we receive new information, so don't be surprised if the forecasts are not the same down the track.

June 2021	2.19%
2022	2.80%
2023	3.50%
2024	4.50%
2025	4.00%

The risk is that my picks for 2023-24 are too low.

My forecast today is that the average rate I would achieve by rolling over one-year fixed rates for the next five years is 3.4%. This is less than the five-year rate at 3.69%. However, that latter rate gives certainty which the short rate does not. Plus, it protects me against the risk that when the one-year rate is high I panic and switch to a five-year rate in 3-4 years which I would not touch with a bargepole now.

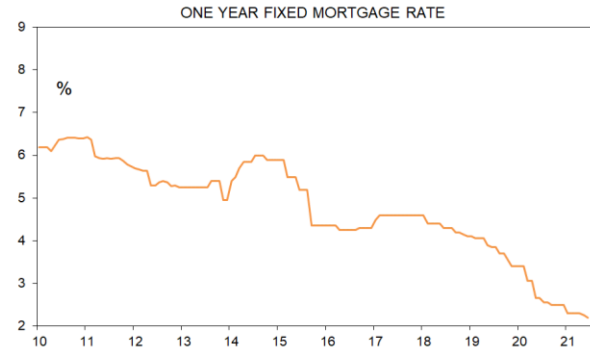
Therefore, taking into account the certainty factor of fixing five years, its about an even call. Few people will now opt for the five-year rate, however. But if that is your preference, you can gain insight into when banks might next move it up with reference to the following graph which shows bank margins on lending fixed five years. I produce this graph plus ones for other fixed lending terms each week in TVP.



Based on my forecasts, the cost of rolling the one-year rate over four years would be 3.25%. The four-year fixed rate is currently 3.39%. The various factors favour fixing four years.

Overall, if you have not locked into the previous attractive 3–5-year rates which I have been making such a song and dance about over the past 12 months, then you've fairly much left your run too late. You're locked into rolling one-year fixed probably now and that means you're going to face a big problem when the one-year rate is well above the long-term rates. Diarise that for some time over the period 2024-25.

My position is that if facing a fixing decision today, I'd probably have one half fixed one-year, one-quarter three years, and one-quarter five years.



TONY'S VIEW

New Zealand's Housing Markets

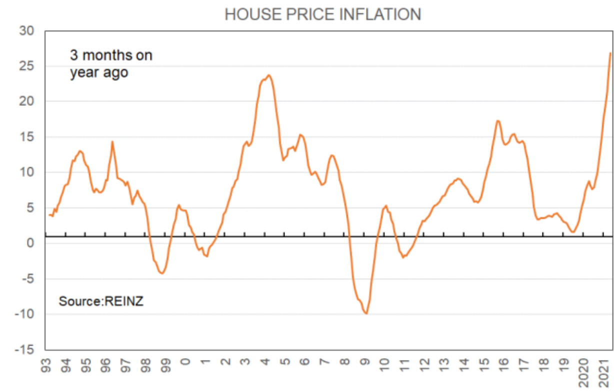
There are lots of house price measures out there, but the only one which I pay attention to is the REINZ's House Price Index at the national then regional and local authority level. Their data reflect signed contracts and therefore is more up to date than other price measures which use transfers of property titles. Such transfers happen many weeks after a sale and purchase agreement is reached. The HPIs also make adjustments for changes in the mix of properties sold each month therefore do not suffer the distortions which market median or average price measures can experience.

REINZ data released on Tuesday tell us that since the government announced housing policy changes on March 23 average house prices in NZ have risen by another 1.6%. Those rises have been 0.6% in April then 1.0% in May.

It is highly likely that many of the sales we have seen recently and the upward pressure on prices at an annualised pace of 10% reflect deals which people may have been pursuing for some time. There has been determination of both buyers and sellers to get a transaction done despite the effects expected to come along from the tax and LVR changes.

So far, we know that these changes have not produced any noticeable rise in the number of listings. Maybe more will come. But when we see reports such as the following regarding a mad scramble for sections in a proposed development in Rolleston in Christchurch, it is clear that very strong demand still exists.
[Clamour crashes site as would-be buyers snap up 100-plus sections in minutes | Stuff.co.nz]

So, to the REINZ data, starting with prices. On average in NZ property prices rose by 1.0% in May to lie 30% up from a year earlier. This is an absurd increase but is explicable by factors such as the following.



- Interest rates for mortgages and bank deposits falling to record lows, and in the case of the latter being negative after tax and inflation.
- Diversion of money people were going to spend on offshore travel, plus buyers shifting future planned purchases into the present because of border closures.
- Widespread perceptions of shortages of properties to buy, properties to rent, and sections to build on.
- Expectations (misplaced) of a flood of expats and foreigners coming here once the borders reopen.
- Removal for a while of LVRs.
- Full blown FOMO up until recently.

On a regional basis increases in the past 3 months from a year ago are as follows.

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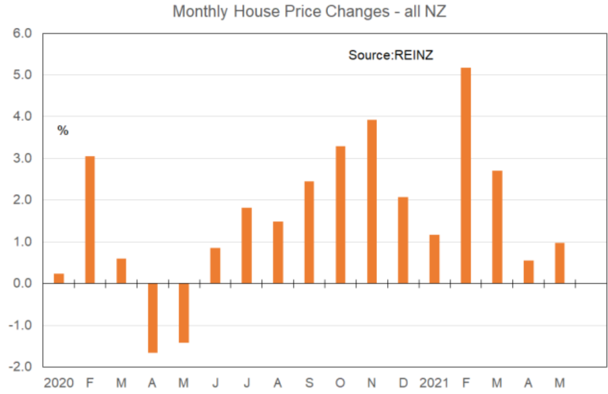
Property Investment Retirement Planning Wealth Creation

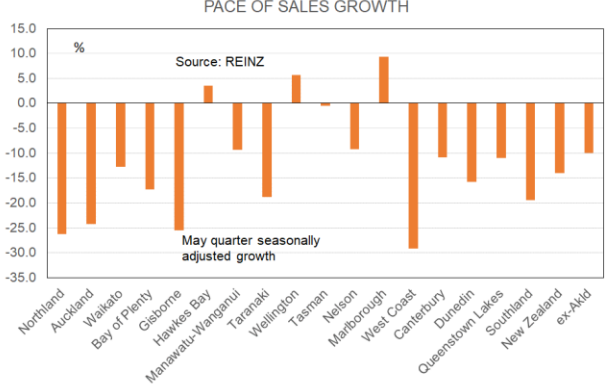
Is the pace of price increases slowing down? It looks like it, but the pace of easing off is gradual. That supports an argument of prices not falling, and also my argument that prices rise 5% or so in the coming year and not the 0.9% predicted by Treasury. There is still momentum.



What about sales? Are they remaining strong?

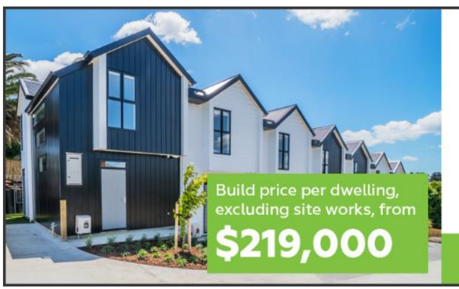
There is no point comparing sales with a year ago given the impact of last year's lockdown. But in broad seasonally adjusted terms we can see that sales are falling – by about 14% in the three months to May compared with the three months to February.

On a regional basis we can see from the next graph that sales have been weakening everywhere recently except in Hawkes Bay, Wellington, and Marlborough.



Finally, can we glean anything interesting from the data on the number of days taken to sell a dwelling on average? In May this number was 30 but it is best to smooth over three months – which gives an average of 29 days. This is six days below average. But in the three months to February the days to sell measure was eight days below average.

So, things remain strong in terms of the speed taken to sell a property, but the extent of the excess speed is slowly easing.



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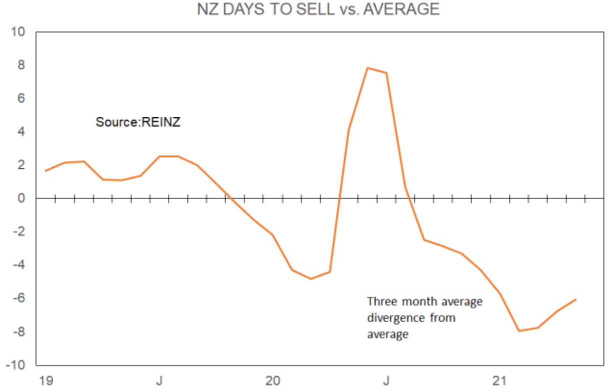
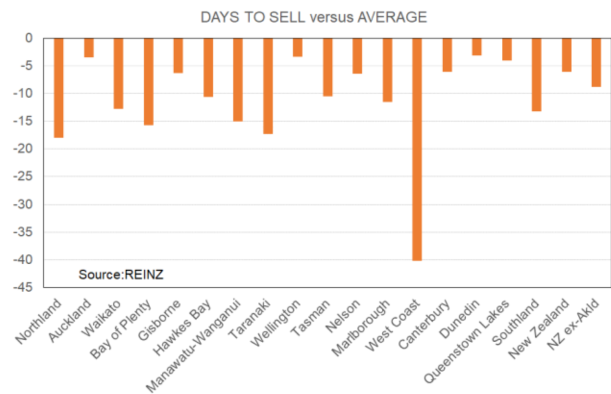


Days to sell are below average in all regions.



The data show a gradual easing in activity and pressure is underway.

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

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Tony Alexander Regional Property Report

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