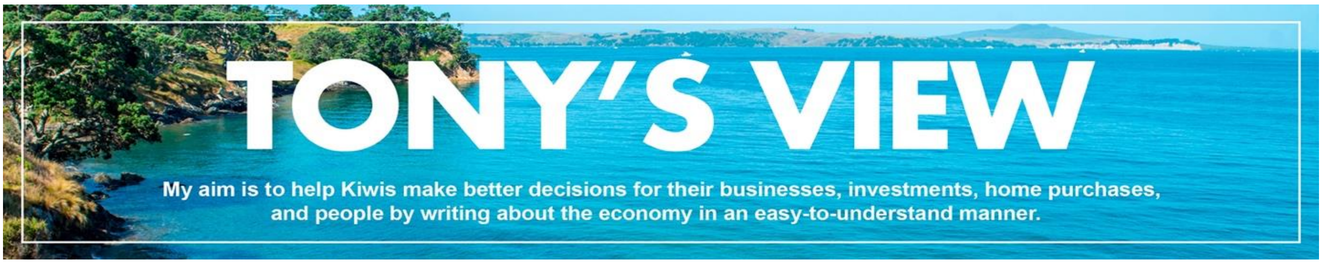


Input to your Strategy for Adapting to Challenges

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

ISSN: 2703-2825 Thursday 15 July 2021

Sign up for free at www.tonyalexander.nz

Rising interest rates – a long time coming

Three strikes recorded against low interest rates

When implementing monetary policy there are three key things which the government has required the Reserve Bank to aim for. Broadly they are

1. Keep inflation near 2%
2. Support maximum sustainable employment
3. Support more sustainable house prices

On all these goals the case has been made for quick removal of the 0.75% cut to the official cash rate undertaken last March, plus removal of the other 0.75% worth of cuts undertaken in 2019.

For inflation, there is no shortage of evidence that prices are rising on multiple fronts, especially in the construction sector. Local authority rates continue to be pushed up at rates well in excess of growth in household incomes, firms are facing much higher electricity charges, insurance costs are going up, vehicle prices are rising. A record net 63% of businesses in the ANZ's Business Outlook Survey recently said they plan raising their selling prices.

Tomorrow the June quarter Consumers Price Index data will be released and a result taking the annual inflation rate from 1.5% to close to 3% is expected.

For employment, one does not have to chat with many employers to learn that availability of staff suitable for employment is extremely low. In fact, indicators show high employment intentions alongside the greatest difficulties experienced sourcing staff since the mid-1970s.

Average house prices have risen by 2.4% since the March 23 tax announcement and reimposition of a minimum 40% deposit for investors. My analysis of the factors driving house prices suggest an average gain between 5% and 10% is likely nationwide for the coming year.

With a plethora of evidence that NZ house prices are extremely high by current world standards and long-term NZ measures, the

Reserve Bank will likely be feeling that additional restraint is needed for the sector – but not very much given the other tools in play now.

There are three strikes in favour of tighter monetary policy and that is why yesterday the Reserve Bank altered the wording in their comments regarding monetary policy.

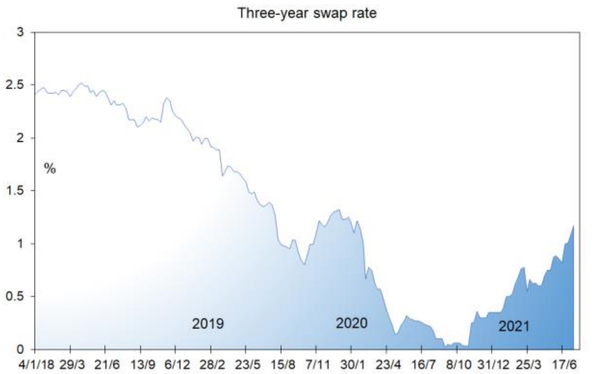
Previously they had noted with regard to inflation that it would take some time for the conditions to be met to justify tightening monetary policy. This time they wrote the following.

"The Committee agreed that, in the absence of any further significant economic shocks, more persistent consumer price inflation pressure is expected to build over time due to rising domestic capacity pressures and growing labour shortages."

Responding to the changing outlook for inflation risks they have decided to cease their money printing operations from July 23. This is a far more rapid change than the markets had been expecting and in some regards is a better expression of the RB's feeling about where inflation risks lie now than the words they used.

As a result, we have seen some further increases in the swap rates which banks pay to borrow money at fixed rates for lending fixed to their customers.

The one-year swap rate is now sitting close to 0.7% from 0.61% last week and just 0.35% four weeks ago. The two-year swap rate is near 1.0% from 0.89% last week and 0.54% four weeks back.



The five-year swap rate is now near 1.45% from 1.37% last week and 1.17% four weeks ago. Back in November last year this rate was 0.1%.

For borrowers the good times are fading and already this week we have seen banks start a new round of fixed mortgage rate rises. For anyone only now starting to think that locking in at a fixed rate for five years would be a good idea – the 2.99% rate I said I'd jump at all last year post-lockdown has disappeared. The rate for that term now ranges from 3.69% to 4.39%.

Handling staff shortages

Last week I surveyed three-quarters of Tony's View recipients, asking for insights into how employers were handling the deepening shortage of staff. Many excellent responses came in and I will release my write-up tomorrow.

But here are the main pointers which I picked up and which hopefully will prove useful to businesses realising they have to change what they do if they are to continue to operate in a robust manner.

1. Offer more flexible hours of work, not just the opportunity to work from home which is not possible in many businesses.
2. Create a strong team environment with spontaneous awards to reflect employee or employee family achievements and milestones.
3. Offer part-time work to retain people who are retiring.
4. Outsource offshore where possible.
5. Don't low-ball initial pay offers as people facing choice will feel disrespected and you've lost a hiring opportunity even if you lift the offer.
6. Automate processes and boost efficiency in order to reduce reliance on staff.
7. Promote from within and make promotion path opportunities clear to new and existing staff.
8. Train people for higher-ranking positions.
9. Hire for potential, not immediate productivity.
10. Provide finders fees to staff who successfully introduce a new employee.

Some of the key pieces of advice included the following.

If you map out a career path for them in your team when you hire them, it focuses them on their growth while staying put.
Try as best to restrict your forward workload to match your resources. The days of "secure that project and worry about resourcing it once you have it" are gone.
We realised a few years back that expecting people to work for a wage alone just wasn't working well enough in our business.
Think outside the square - new mums who are on maternity leave could work from home if there are jobs that can be passed on to them.
Making the most of walk ins, turning applications into job offers within 24 hours.
A friend of mine … set up a referral scheme with a cash prize of $500 for a candidate that stays the course.
Not looking forward to borders opening and young staff bolting to do the OE.
Promote within for the hard-to-find roles and back fill the easy ones.
Using Student Job Search we employ at no recruitment or advertising cost, smart students. We use these to pad out full time staff so that fewer full timers are needed.
I am now promoting more from within the organisation, on the basis of potential capability not proven capability. It's turning out to be a wonderful strategy.

Population change is not the main house price driver

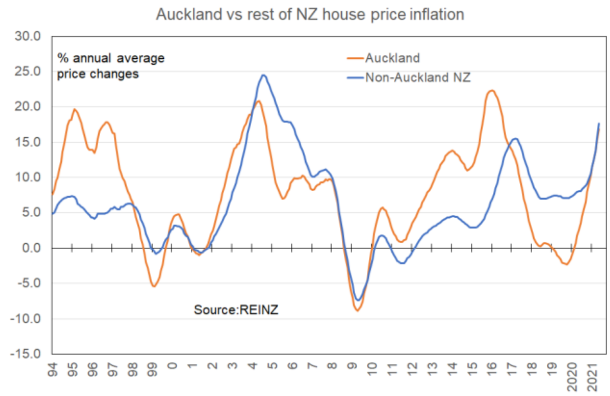
During the week an emailer noted this information.

"I used to use this buying guide for investment properties. Take a $1m house in Auckland, people could not pay more than $600 per week rent. If you bought 4 houses in South Canterbury (Waimate, Temuka or Geraldine), that would cost you $1m total, you would get $300 per week per rental (=$1200 per week). Yes, not as much capital gain but some people (like us) want a cash cow and are not really interested in capital gain like Wgtn and Auckland."

This is something important about the housing market in New Zealand. Investors have for the past 3-4 decades displayed a high willingness to invest in locations well away from where they live. This tendency was turbo-charged by the Reserve Bank in 2015 when they temporarily applied a higher minimum deposit requirement for investors buying in Auckland than elsewhere.

Aucklanders flocked to other locations where their deposit could stretch to buying a house no longer accessible in Auckland. Seeing the impact of their actions the Reserve Bank's next change effective in July 2016 was to require a 40% deposit for investors everywhere in the country.

But the tendency to buy-away was already there and remains so today. That is one reason why despite not having the shortage of houses Auckland started building up from 2005, we quickly saw the regions following Auckland's prices surge from 2012-16 where their average house price doubled.



The table on the next page shows for each NZ region the change in population between 1991 and 2020 in the first column of numbers. The second column shows the change in house prices between calendar 1992 and the year to May 2021.

Auckland's population over the 29-year period has grown by 85% and average house prices have risen by 727%. Dunedin's population has risen by 17% and average prices have gone up by 795%. The population in the Tasman region has risen 66% and house prices have gone up 485%. The West Coast's population has gone up 3% and prices have gained 436%.

Population growth alone is not the key determinant of house prices changes around NZ regions. This means something significant. You don't want to base your forecasts of house prices on population forecasts.

	Popn growth 1991-20 %	HPI 1992-21 June yrs %
Northland	53	473
Auckland	82	727
Waikato	51	537
Bay of Plenty	65	563
Gisborne	14	541
Hawke's Bay	29	542
Taranaki	16	418
Manawatu-Wanganui	13	451
Wellington	35	574
Tasman	66	485
Nelson	50	432
Marlborough	43	432
West Coast	3	436
Canterbury	47	354
Queenstown	374	474
Dunedin	17	795
Southland	3	484
New Zealand	51	576
ex-Auckland	39	487

For your guide (because you're going to do it nonetheless as you think it makes sense), here are the Statistics New Zealand projections for regional population growth between 2018 and 2048.

	Projected population growth % 2018-2048
Northland	24
Auckland	39
Waikato	29
Bay of Plenty	26
Gisborne	12
Hawkes Bay	17
Taranaki	14
Manawatu-Wanganui	12
Wellington	16
Tasman	19
Nelson	11
Marlborough	8
West Coast	-6
Canterbury	25
Queenstown	60
Dunedin	8
Southland	8
NZ	27
ex-Akld	21

The total NZ population is projected to grow by 27%. For Auckland growth of 39% is projected, Wellington 16% which is only just ahead of Manawatu-Wanganui at 12%.

For all of New Zealand excluding Auckland, population growth of 21% is projected.

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 and you should discuss your financing options with a professional.

This week, in light of yesterday's comments and actions from the Reserve Bank, the interest rate forecast which I am running on is that the Reserve Bank raises the official cash rate by 2.0% starting next month This outlook generates the following forecasts for where the one-year fixed mortgage rate will sit in July for each of the next few years. I have allowed for banks recouping half of the gap between where their margin sits currently and where it has averaged for the past two years.

	Forecast 1 year Fixed rates	Rolling average rates	Current fixed
2021	2.19		2.19
2022	3.50	2.85	2.55
2023	4.50	3.40	2.99
2024	4.50	3.67	3.39
2025	4.00	3.74	3.69

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 2.85%, three years 3.40%, four years 3.67%, and five years 3.74%.

The last column shows what the current minimum fixed rates are for those time periods. When you take into account the premium one should be prepared for rate certainty, value strongly remains for fixing over rolling at the one-year term as many people have planned to do.

I've spent the past year trying to warn folks about the upside risks to interest rates and hope that a good number did manage to fix their rates if not for five years at 2.99%, at least for the likes of three years at 2.65%.

If I were borrowing right this moment, I'd be inclined to spread my risk over the one-, and 2-4-year periods. Good luck.

NZHL Tony's Thoughts Video

Each week I record a three-minute video for NZ Home Loans and in the most recent one I discuss rising interest rates. Enjoy.

The landing page for these videos is here.

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

mortgages.co.nz & Tony Alexander Mortgage Advisors Survey

mortgages .co.nz

Tony Alexander Regional Property Report

FIRST MORTGAGE TRUST INVESTMENTS | PROPERTY FINANCE

Valocity Valuer Survey

VALOCITY

Crockers & Tony Alexander Investor Insights

Crockers PEOPLE & PROPERTY

One-off issue of Tview Premium

To receive a one-off copy of Tview Premium for $15.00 incl. GST, being this week's issue only, there are two payment options offered in order to keep admin simple at my end. Be sure to enter your email address correctly as that is where the issue will be sent. All payments received up until next Wednesday night will elicit a TVP of the same date as this TV. All from next Thursday morning will receive the next TVP issue. Any problems, just email me.

PayPal

POLi