TONY'S VIEW

Input to your Strategy for Adapting to Challenges

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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.

The half-full glass

My approach to analysing and commenting on the current virus crisis has been to avoid highlighting worst case scenarios and instead try to focus on the most likely developments based on some understanding of human nature, our economy, and recessions generally. Others have taken a different approach.

In simplistic terms, let's say I have a glass half-full attitude to the world and this recession while others see things the other way around. The story around the planet this week has been one of a general taking up of the glass half-full interpretation. Data have emerged in many countries showing retail spending lifting again, manufacturing and construction coming back on stream, confidence levels becoming less dire, and lockdowns bit by bit being eased. The chances that we move to Level 1 come June 24 midnight are increasing by the day, and an early Trans-Tasman bubble by the July school holidays is possible.

Basically, a scenario better than the best scenario used by Treasury in their modelling appears to be in play, and forecasters with some decent models are starting to pare back their predictions of economic shrinkage and how high the unemployment rate goes.

This moving of sentiment toward embracing hope of better times ahead is one key characteristic I've reckoned is different for this recession. In the past we have tended to be fairly despondent here in New Zealand, seeing nothing but woe in the early quarters of a downturn. We invariably talk about leaving the country and a brain drain. We talk about the regions emptying out, and so on.

But this time around none of us think New Zealand is stuffed. In fact, we believe we've done a good job and that the rest of the world will want to shift here. Many of us want to travel overseas when borders open again, but fewer of us are now thinking about leaving. The rush of Kiwis coming here and not leaving from December last year backs this brain gain scenario (I used to have a website with that very name.)

In wonderful hindsight it looks like Level 4 lockdown was not needed and emerging research around the world is showing that big differences between lockdown strictness yield very small changes in infection and fatality rate control. Shopping is safe, as are outdoor events. Timing seems important as does adherence to basic hygiene, isolation, and tracking rules. But we all make mistakes so it is hard to be too critical of our government – even though one day it would be nice if they started to exercise some fiscal control, the Reserve Bank veered toward lesser rather than more money printing, and some concept of a recovery strategy based around sustained private sector growth would appear. A test coming for them will be the extent to which they do not spend the $20bn left over from the dreamt-up $50bn spending fund announced in the Budget.

Around the world sharemarkets have rallied so that the likes of the Dow Jones Index in the United States is now only around 14% off its peak following a 37% fall by late-March. The Kiwi dollar is sitting near 62 cents, and some bond yields have started to creep up offshore.

We are not out of the woods by any stretch of the imagination. Artificial support for our economy from monetary and fiscal policies will be needed for a while yet. And many companies, even if minimally affected by the recession itself, will be making some staff redundant as they engage in long-overdue restructuring and refocussing after some easy growth years.

But as each week goes by, and despite bad jobs news, expect to see more businesses playing things from the optimistic, glass half-full side. After all, investors in equities have been doing so since March 24.

Jobs growth

All around us we can see job losses as a result of the combined effects of Covid-19 and all sectors throughout the country catching up on delayed restructuring and getting prepared for the future. The government has enacted some programmes to get more people into training and education, to encourage companies to retain apprentices, and to get some people hired on unspecified infrastructure projects and an expanded Taskforce Green scheme.

But none of these things are what really matters. The key to labour market strength and recovery lies always in the private sector, and in that regard New Zealand is better placed to soak up unemployed people than many other countries.

Our labour market is highly flexible. In some countries it is virtually impossible to lay people off. That discourages hiring in the first place and has had bad social consequences in some European countries. Some countries also have a multitude of extra costs which employers must pay when they employ someone. We have some of those as well, but not as many such imposts.

The government has retained the 90-day trial period for new hires by businesses with 19 or fewer staff. This is vital at times like these because it gives businesses an ability to try someone out not just in the sense of seeing how they perform, but in seeing whether their prediction of customer demand for goods and services is correct or not. These are very uncertain times and market predictability is low. The trial period cuts the cost to businesses of hiring someone and getting it wrong.

We Kiwis also tend to be highly flexible when it comes to our working location. This willingness to move around the country stands in contrast to many Mediterranean countries where people tend to stick near their village. That means that if new jobs are not appearing near where the old ones were lost, unemployment tends to remain high.

We also have the "advantage" in New Zealand of high house prices having kept many young people out of home ownership longer than would otherwise have been the case. That increases their ability and willingness to move to where the new jobs will appear, whereas a homeowner will naturally tend to want to stay put and wait for a local job opening to occur. It's hardly something you'd pursue as a policy goal however.

We also have the advantage that unlike Australia and the United States, people made unemployed by this crisis are not in many instances now earning more than when they were working. Some governments overseas may have difficulties winding back bonus weekly jobless payments given to unemployed people through the crisis and that will impede jobs growth – for a few months maybe. Technically, the special lift in the benefit paid to newly unemployed people will impede willingness to accept new work (most especially the expanded Taskforce Green scheme). But it is temporary and who can truly begrudge some special assistance when such a large shock comes along as opposed to "normal" employment rotation.

When will the new jobs start to appear on a generalised basis, as opposed to the few businesses currently doing well out of the lockdown and/or the initial freeing up of our movements? Probably later this year, with net job creation turning positive hopefully fairly quickly. But just as we cannot currently see the bulk of redundancies being made because they are not occurring in big headline firms, so too will we not see the new jobs being created. Only when the likes of a big construction company hires a quick 100 people will you see headlines of good jobs growth occurring.

This is one of the ways in which when an economy is improving, the bulk of people simply don't believe it. So, when you do come to start looking for new staff, look through the generally negative comments you will still see in the media and hear around you. In every recovery there is a disconnect between the opportunities you see on the ground and the actions you are prepared to take in your small business, and the backward-focussed discussions in the media. Why backward focussed? Because those discussions will be based on out of date data.

Domestic Travel

Don't be afraid of getting on the North Island's main road to go and see the country just because you haven't done so for years and have memories of bad road conditions. I drove from just north of Wellington to Auckland CBD two Sundays ago and it only took 7 hours 20 minutes at the speed limit all the way with one petrol stop. Coming back last Friday took an hour longer reflecting more traffic on a weekday plus roadworks.

Apart from the length of road between Levin and the start of the Kapiti Expressway north of Waikanae, and still having to go through almost the middle of Hamilton, the road was great. I was on cruise control for around 95% of the trip each way – both times leaving around 5.00am.

Once Hamilton gets bypassed by the Waikato Expressway and the Transmission Gully Motorway

plus expressway to north of Levin all get completed, the drive off-peak between Auckland and Wellington will be less than 7 hours.

Net debt blowout

People are rightly concerned about how much extra debt the government is taking on to help get the economy through this slump. Personally, I'm more concerned about the absence of any growth, recovery, or business plan.

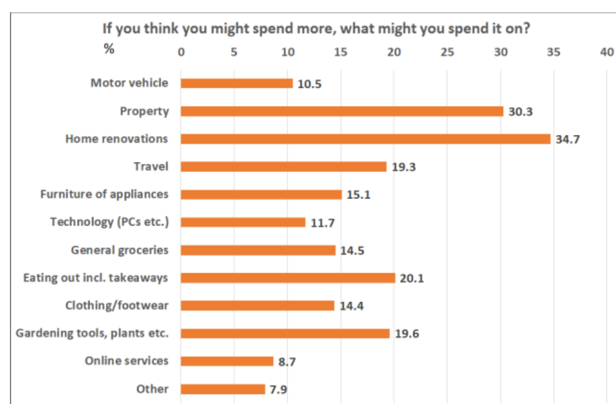
For your guide, NZ's ratio of net government debt to GDP will rise from less than 20% recently to about 55%. Currently the net debt to GDP ratios in some other countries are these – before they add on their Covid-19 debt.

Japan	154%
Italy	121%
France	93%
United States	81%
United Kingdom	78%
Germany	40%
Canada	25%

In other words, our end point is still better than the starting point of most of the G7 member economies.

The renovation boom

One of the key findings in my first Spending Plans Survey undertaken four weeks ago was a high proportion of people reporting that they are planning to spend more on home renovations.



Validation for this phenomenon has come this past week across the Tasman. In Australia the trade booking platform Hipages has reported a 79% rise in jobs nationwide loaded for kitchen renovations, and 87% rise in concreting work in NSW.

Auckland-based Fergus revealed recently that on its job management software a surge of projects had been created in readiness for the shift to Level 2.

"New Zealand tradies saw a welcome huge surge in jobs as lockdown lifted with a record number of new work projects created ready to start on April 28th." https://fergus.com/tradehub/

This surge in activity for tradespeople may go some way there and here to offset the falling away of new home building projects – so far down by 30% in Australia. A similar house building decline is likely in New Zealand. If our numbers fall 30% from 38,000 that means over 11,000 fewer houses than expected being built. This would offset the housing demand effects of almost a 32,000 net migration flow.

Recent Publications

What property valuers are seeing.
http://tonyalexander.nz/resources/Tony's%20View%20Valuers%20Survey%20May%202020.pdf

What real estate agents are seeing.
http://tonyalexander.nz/resources/Tony's%20View%20Real%20Estate%20Survey%20May%202020.pdf

Kiwi consumer plans for spending.
http://tonyalexander.nz/resources/TV%20Spending%20Plans%20Survey%20May%202020.pdf

Things which might be better as a result of this crisis.
http://tonyalexander.nz/resources/TV%20Covid-19%20No.8%20Supplement.pdf

Things which will slightly limit housing weakness.
https://www.stuff.co.nz/life-style/homed/121227636/heres-why-house-prices-may-not-fall-as-far-as-you-expect

Recession elders passing on their knowledge to newbies of what to do when these bad times arrive.
http://tonyalexander.nz/resources/TV%20Covid-19%20No.7%20Supplement.pdf

Emailed Queries

Will this recession lead to a new class of long-term unemployed people?
Yes. Every recession does. The challenge is for the government first of all to try to limit the loss of jobs in any recession through supportive policies. This time around those policies have focussed on assisting firms to carry staff through the period of greatest weakness in our economy – and that period for most has now ended with the lockdown over.

The policies then need to focus on limiting the number of unemployed people who lose connection

with the labour market. This involves the $1.6bn allocated in the Budget for retraining purposes, plus the $1.1bn allocated for green-type projects (which will almost certainly not attract the 11,000 employees hoped for).

Alongside that we have longer-term policies aimed at providing real jobs, such as bringing planned expenditure forward in time, and creating new items of expenditure such as expanded infrastructure construction.

Governments can then if they like focus on removing barriers to employers hiring unemployed people. In New Zealand there are few such barriers and our labour market is highly flexible, but some tweaking could probably still be done around the likes of the 90-day test hiring period and some of the non-wage costs associated with hiring new people. Overseas this is where big problems arise. In Europe particularly, labour markets are geared toward retention of jobs by those who already have them, and outright disincentives to take a risk hiring new people. This has already created large underclasses of young unemployed people in many European countries such as France, and the social problems associated with youth disconnection from employment are likely to worsen there.

None of the policies mentioned above will avoid some people falling out of both the education and employment systems. And that is where social policy will need to come in – identifying communities, cohorts and individuals who have lost contact, and working with them to get them into training, education, or useful employment of some sort.

Therefore, if I were of social policy bent, I'd be setting up a business aimed at assisting the government's existing agencies in identifying and assisting such people at risk of long-term unemployment as quickly as possible.

What is money printing?

People keep asking this question so I've written a small explanation which I will cut and paste into replies to emailers asking – and here it is.

Money printing does not mean the actual production of extra coins or bank notes. It goes like this. The government is running a deficit which it finances by selling bonds to investors. For each $1mn of deficit they will sell $1mn of bonds and that means there is no net injection of extra funds into the money system.

Now, imagine you are an investor with $1mn in your bank account and you plan buying government bonds which will be issued to finance the deficit. Just before you do so the Reserve Bank buys the bonds instead (probably not directly from Treasury but from someone else in the market who was already holding the bonds or had just bought them from Treasury.)

Now, the financial system has not just the $1mn deficit amount which might reflect higher benefits or wage assistance, but your $1mn which is still sitting in your bank account. Bereft of the bonds you wanted to buy but which the Reserve Bank bought instead, what do you do with your $1mn? You might spend some at the shops, you might leave it on deposit with your bank, you might invest in other assets like shares or property.

The printed money is your bank deposit. The Reserve Bank's hope in snatching away the bonds you were going to buy is that they push interest rates lower than would otherwise be the case, that banks finding lots of money on term deposit will lend out more, that you might buy a new couch, and that people will feel slightly wealthier because you buy an asset and prices of those assets go up.

That latter effect is not spoken about by our central bank because it is politically incorrect in New Zealand to speak about policies designed explicitly to push up property prices. But that was the expressed intent of the Federal Reserve in the United States when they engaged in money printing after the Global Financial Crisis and it will happen here as well – eventually.

Shouldn't the government have released a business growth strategy with their Budget?

There was certainly no strategy for driving stronger growth in our economy in the Budget. But then there wasn't one before and it would be unreasonable to expect that whilst dealing with a global pandemic and structuring policies to support people and businesses through the worst of the downturn, that Cabinet ministers and the public servants working for them would have the time to develop an over-arching multi-year growth plan.

More than that, the current government unfortunately has revealed inadequacies with regard to development and implementation of growth strategies in just one sector (e.g. KiwiBuild) so expecting them to achieve competence in a plan stretching across multiple sectors would be out of touch with reality. But in terms of pulling out all the stops to assist our economy through the worst of this downturn, I rate them highly.

Are banks actively reducing their capital ratios?

The RB still plans having them raise their Tier One capital ratios to 18% over seven years starting from next year, so I fail to see any sensible bank leader

would want to undertake that process from an extra low starting point. They'll get extra capital from their Aussie parents if needed and investors seem quite eager to give capital to banks and other companies raising funds currently. Plus, the banks are not permitted for now to send dividends across to their parents and that will provide extra long-term capital if needed when the worst of the credit cycle is over.

Is it a good time to buy an early childcare centre?

Before Covid-19 struck I met someone who had to underwrite the sale of a bundle of childcare centres which failed to attract sufficient investor interest from the public. I'm of the view that people looking to save money will seek informal childcare options from local people in their houses (whether meeting rules on maximum child numbers or not) rather than centres, and that increased working from home will lead to a structural decline in demand for childcare places. How much is unclear. The sector has exploded in recent years with high ownership by investors and substantial investment in flash premises.

Personally, unless someone were offering me a heavily discounted price, I'd be wary of the sector at the moment. I have no insight to offer on subsidies though note that while funding per hour per child continued to be paid to centres during lockdown and now, before the year is out many may experience funding loss with child numbers and attendance hours down.

My wife is Chief Executive of www.childforum.com

How come with all this uncertainty the NZ sharemarket is higher than a year ago?

I don't analyse equities but can note that central banks and governments are throwing their kitchen sinks at containing the economic weakness from the virus shock and getting extra money in play in the hope of stimulating future growth. Throw in low interest rates and the evidence post-GFC that money printing drives asset prices higher and you have the strong gains we have seen in sharemarkets since March. As regards our sharemarket before February - not really my field.

We're seeing huge demand for flooring. Will this level of sales activity continue?

I believe that having been locked up for seven weeks people are engaging in some long overdue home renovations and sprucing up. But I believe this surge will pass and then your activity levels will drop to below normal in reflection of high unemployment and people feeling generally pessimistic. Having said that, I am of the strong view that we will all look through a lot of the weakness we are going to see around us toward the better times over 2021-22 and that means we won't all crunch our spending to the minimum. It will be a unique feature of this recession.

All that such an outlook signals to me with regard to the likes of people enjoying a sales surge at the moment, is that extreme caution should be exercised regarding thoughts of store expansion. If the surge does not last then you might lose your business not because of weak consumer spending, but because you geared up and expanded in full knowledge of the worst downturn hitting us since the 1930s. That explains why the chances are high that no bank is going to finance such an expansion anyway.

New Zealand's Housing Markets

Housing insulation

There was a brief article on the television last Saturday night noting the high level of interest in Open Homes from first home buyers – though they did not actually show a lot of people. The article illustrates one of the interesting aspects of debate about the housing market this recession as compared with that over 2008-09. No-one is forecasting massive price falls.

We all can see that many people will lose their jobs this time around – more than back then. But the weight of factors supporting house prices, and in particular limiting the level of forced sales by vendors, is simply too great. Prices on average will decline, but no-one has prophesied a 40% fall as one online journalist did back then. The biggest number I've seen is 15% which represents the top of the forecasters' offered range of 10% - 15%.

I'm in the 5% - 10% range for the NZ-wide average but with some very high variations. Biggest declines are likely in Queenstown and Auckland inner city, followed by the regions. Our biggest cities representing 57% of our population (Auckland, Wellington, and Christchurch) are likely to show only slight declines.

Auckland will be specifically insulated by inflows of people from the regions looking for work, and removal of Loan to Value Ratio rules making purchasing once more achievable for people who since late-2013 have had to search in the regions.

Wellington will be insulated by the role of government in the economy and limited exposure to international tourism. Christchurch will be insulated by the lack of price movement in recent years and analysis showing the region is undervalued.

There will also be some insulation for Hamilton because of its momentum, proximity to Auckland, shortages, and the expressway developments.

The factors which will limit price weakness nationwide include the following.

1. Removal of LVRs making a purchase possible for those who do not have enough cash to make a 20% deposit, or 30% in the case of an investor.
2. Record low interest rates which have just gone lower and will probably go lower still. Two-year fixed rates have now declined to only 2.69%.
3. Money printing which, based on the experience of other countries following the Global Financial Crisis, will apply upward pressure to prices of assets such as property and shares.
4. Work changes which reduce the attractiveness of commercial property investment, causing some investors to switch their focus back to housing.
5. The fact that the bulk (not all) of people who will lose their jobs will come from the hospitality, tourism, and retail sectors where incomes are low and highly variable. Many people in these sectors are young, do not own a home, and would not have qualified for a mortgage given their income circumstances.
6. The proportion of our workforce who are migrants on temporary working visas has risen from 4% in the last recession to 8% now. They have accounted for 25% of jobs growth over the past 12 years, and many are in the sectors just mentioned. Most migrants laid off will have to leave the country when flights allow it. This will dent rents but have far lesser impact on prices as they are not property owners.
7. The imposition of LVRs since 2013, application by banks of high Applied Interest Rates (for calculating debt-servicing ability of borrowers), and the requirement to "lend responsibly", means there are few people with high levels of debt and low equity in their properties.
8. Outside of Auckland average house prices have risen by 30% since 2016. The bulk of buyers will have built up good equity in their properties.
9. The mortgage deferral scheme gives people whose incomes have fallen, time to get new work or generally rearrange finance and spending in order to continue servicing their debt.
10. The uniqueness of this shock means we all struggle to feel sure we know how things will pan out. This uncertainty means banks cannot work out how risky each type of

lending has now become. Unable to state hand on heart that they are definitely lending responsibly the bankers have no choice other than to cut back credit on all but the least risky area of lending (which is housing). That means construction of houses may well fall the 30% picked last week by the Fletcher Building CEO, and that will worsen shortages. My pick is the fall will be a tad less than 30%.

11. There is strong evidence of Kiwis returning from overseas, planning to, or purchasing properties here while they complete their careers offshore. There may have been a structural shift in the net flow of Kiwis from NZ toward gains from decades of losses each year.

Australian developments

There is no strict correlation between the Australian housing market on average and our own. And, because of the more strict lockdown imposed here (which in hindsight doesn't look like it needed to be so bad), our government has inflicted greater lockdown pain on our economy than Australia's.

But analysis of our housing market can nonetheless be informed by developments across the Tasman. In that regard we are seeing support for my central argument since the start of this that we will not see a rush of panicked sellers hitting the market causing prices to fall sharply.

Auction numbers in Australia have recovered to be about one-third of what they were a year ago. But clearance rates have lifted back to where they were in early-March. Agents report that while the number of buyers has declined, their biggest problem is getting vendors to come back to the market.

One agent noted "Of people who pulled out, most haven't come back. They're still sitting on the side-lines" But one potential sign that vendors are increasingly confident they can get a good price is a decrease in the number of properties being sold before auction – that is, vendors preferring the certainty of a fixed price sale rather than taking on the cost of an auction and risking a weak price.

Another report in Australia noted a surge in first home buyer enquiries, encouraged particularly by record low levels for interest rates.

New Hong Kong flows?

Tensions in Hong Kong have been growing in recent years as China has been moving early to assert control over its special administrative region ahead of full control arriving 50 years after the handover from Great Britain in 1997. Currently, China is intending to impose new national security laws addressing subversion, sedition, and foreign interference. The changes are likely to provoke a new wave of street protests and the United States has indicated it will remove the special status which it accords Hong Kong.

The changes would damage the much-liked autonomy of Hong Kong which makes it so attractive as a financial centre and one outcome is likely to be a withdrawal of capital and businesses generally to the likes of Singapore and maybe back to London and Australia. Reinforcing these outflows may be the announcement that Chinese state security bodies will soon set up offices in Hong Kong.

Ahead of the handover in 1997 we saw a good number of people from Hong Kong migrate to New Zealand, with a concentration of these people, and construction related to their movement, in and around the suburb of Howick in Auckland. It seems likely that as prospects for freedom and business in Hong Kong worsen that we will see a lift in the number of people living there shifting to New Zealand – including Kiwis returning home. Once the borders open.

If the government were by chance looking for quick bang for admin buck from a scheme aimed at attracting foreign capital and skilled people into New Zealand to help drive our recovery next year, creation of a special visa for Hong Kong people escaping the world's resurrected biggest authoritarian state would seem like an idea worth investigating.

Interest Rates

Wholesale interest rates have moved slightly higher this week, principally in response to improving sentiment regarding the world and NZ economies. The one-year swap rate has edged up to 0.25% from 0.21% last week, and the three-year rate to 0.24% from 0.16%.

90-day bank bill yields however are closely anchored to the official cash rate, and as that rate will sit at 0.25% through until at least March next year, the bill yield was unchanged this week at 0.26%.

Now that bank mortgage interest rates have fallen even further (see discussion below), a lot of people are thinking about breaking their current fixed rate to reset at something lower. That is, people want to break the contract they have signed with their lender. The benefit to the borrower seems obvious – stop paying an old fixed rate above 4% and start paying a new rate of perhaps 2.79%.

But when the bank loaned you money fixed at 4.5% for three years say, they borrowed money from someone else for a fixed term of three years at a rate which was probably close to 3.3%. The bank cannot go along to that person and give them their money back.

So, if you want to break your contract the bank will calculate a cost which you must pay, representing the difference between what your old rate was and how much the current rate is for the term left on your loan. They will calculate a cost which leaves them in the same position as if you had not broken your rate. This cost can be high and in most instances is not worth paying. In fact, your incentive to do so is less now than it may ever have been before. Why?

Because in the past we would think in terms of new low fixed rates possibly being temporary and people wanted to break to take advantage of a window of opportunity to fix before rates went back up again.

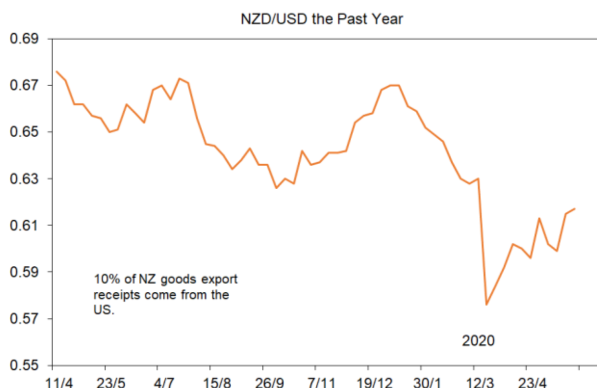
But this time around there seems to be no need to hurry. Central banks around the world are at pains to emphasise that they are going to keep interest rates low for years. The chances of inflation springing up and requiring much tighter monetary policies over the next three or so years are very low.

In other words, if you let your current fixed term run to its end, you'll probably still be able to fix anew at a record low rate.

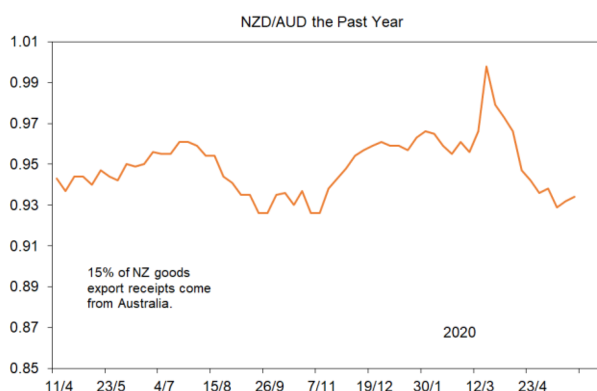
You might notice that in the fixing options canvassed in the rates section below I never discuss breaking a mortgage. It's usually not at all worth it unless a miracle has occurred to give you an ability to forecast interest rates which you clearly did not have when you signed up for your fixed rate.

NZ Dollar

With some better news on the economic front around the world investors have embraced more risk in their investments, and that means the NZD for a while climbed above US62 cents for the first time since the middle of March. But it couldn't stick there in the face of some profit-taking and China tensions, and this afternoon is basically where it was last week just above 61.5 cents.



Against the Australian dollar the NZD has also ended the week not much changed from seven days ago near 93.4 cents.



One factor which might push the Kiwi dollar lower over the coming year is reduced income from dairy exports. Fonterra take just over 80% of the milk produced in New Zealand and have announced that following a mid-point estimate for this year's payout of $7.20, next year's mid-point is currently $6.15. Translated across the whole sector this would entail a fall in export receipts of perhaps as much as $2.5bn. Out of a GDP near $300bn that means near 0.7% taken off our economy.

And so, to repeat a point made here previously. The farming sector will not lead our economy out of recession.

But even though goods export receipts overall will likely fall, there are still other factors in play which can push the NZ dollar higher this coming year. One of these is continued recovery in the world economy from the Covid-19 shock. Improving growth translates into increasing willingness of investors to purchase riskier (more volatile) assets, and that includes shares plus the NZ dollar and currencies of other commodity exporters.

But offsetting that is the NZD weakness which will follow the increase in tensions between China and the United States, and now more generally, China and the rest of the world. As China moves to extend its authoritarianism outside its land borders the world is pushing back against this destabilising force.

Over 30% of our merchandise export receipts come from China. For Australia the proportion is over 38%. Our incomes are vulnerable to not just weakness in China's economy, but punishment if we fail to stand silent while China takes moves to control critics and non-followers in other countries.

We need to anticipate that our economy will at some stage be negatively affected by China's attempts at control outside its borders. This will be through either, and possibly both, specific trade sanctions levied against us in an attempt to force obedience, and/or a generalised global trade war focussed on China. Welcome to this century's conflict.

If your income is heavily dependent upon selling to China you should be actively seeking alternative markets. And before anyone refers to the free trade agreement between NZ and China perhaps providing some protection, Australia's trade deal with China has counted for little as China has punished Australia for its pushing of an investigation into origins of the virus.

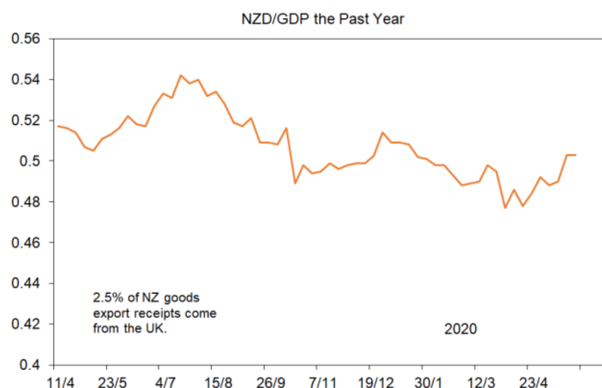
China may have given the world a good lift in economic activity and incomes these past couple of decades. But it has also delivered the worst downturn since the 1930s Great Depression, with assistance from incompetent leadership in the West.

For New Zealand and the NZ dollar there are therefore developing downside risks from

- China's economy no longer growing as fast as before because of loss of trade with other countries, reducing access to foreign technology, and businesses shifting production and investment out of China,
- specific pressure from China to not impede their military expansion and authoritarianism,
- the natural Kiwi pushback against bullying behaviour – as evidenced when NZ went nuclear-free despite US opposition and eventual punishment.

For us remote Kiwis the 21st century's central conflict of China expansion and rest of the world pushback, isolation, and containment, may seem just another version of the 1950s-1980s US-Russia Cold War. But we never received 30% of export receipts nor 11% of our tourism income from the USSR. We are involved and our economy will receive disturbance from this source. As countries move their supply chains out of China, you'd best be shifting your export sales focus to South East Asia, India, and back to the UK and EU. Australia also if possible.

Back on exchange rates now. The NZD has moved up against the British Pound over the past few weeks to consolidate for now above 50 pence. One factor driving this rise has been the continued openness shown by the Bank of England toward negative interest rates. This stands in contrast to outright opposition from central banks in the US and Australia, and the mixed messages from our own central bank which seem to veer toward not favouring the option. After all, there is no evidence that zero official interest rates boost either the pace of economic growth, credit flows, or inflation.



CHOOSING YOUR FIXED MORTGAGE RATE TERM

With more pressure coming from the Reserve Bank, the week has brought some further cuts in fixed mortgage rates. The one-year rate however still remains the lowest.

Current minimum fixed rates across the main banks. *

1 year	2.65%	down from 2.79%
2 years	2.69%	down from 2.95%
3 years	2.99%	down from 3.35%
4 years	2.99%	down from 3.49%
5 years	2.99%	down from 3.59%

I can fix 1 year at 2.65%.

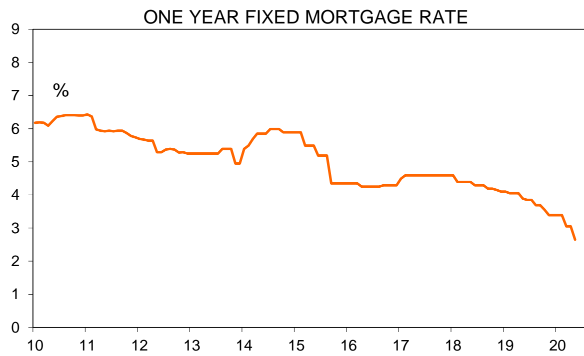
Is this better than fixing 2 years?	Yes, if in 1 year the 1-year rate is below 2.73%.
Is this better than fixing 3 years?	Yes, if in 1 year the 2-year rate is below 3.16%.
Is this better than fixing 4 years?	Yes, if in 1 year the 3-year rate is below 3.10%
Is this better than fixing 5 years?	Yes, if in 1 year the 4-year rate is below 3.08%.

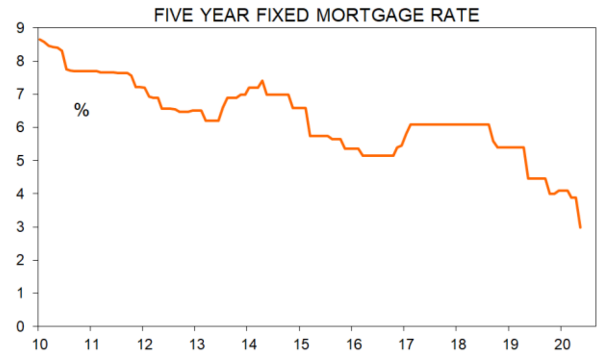
The above table says that it is best to fix for just one year if in one year's time the 2-4-year rates are lower than 2.73% to 3.08%. The chances of actual rates being lower than those shown are now maybe 50:50 for the one-year rate, and 75% for the two-year rate. But I'm thinking that with the growth outlook improving, the yield curve will start steepening again at some point within the next year, and chances are not high that the three- and four-year rates a year from now will in fact be lower than those shown. This then makes things more complicated for those borrowers who are not interested in simply chasing the closest candy held out by bankers.

I am a conservative borrower and have long said that if someone were to offer me a three-year fixed rate at 3.3% or less, I would probably take it. I can get 2.99% from one bank. In fact, they offer that rate out to five years. That is good enough for someone like me who favours rate certainty. Having lived through many periods of economic despondency and euphoria I know that the natural tendency of all of us is to extrapolate the most recent rates trend and to assume rates stay at those levels for a long time. These rate expectations count for a lot and help explain Reserve Bank monetary policy actions and comments.

If I were borrowing at the moment, I would fix five years at 2.99%. But cash flow is king currently, and most people will go for the one-year rate at 2.65% - saving just 0.24%. For me, that 0.24% is a very low charge for rate certainty over the next half a decade. Think about it and ask yourself. If you veer toward the optimistic and believe our economy will be improving next year, you'd best be expecting a surge in expectations of extraordinary monetary policy easing ending. That is what pushes medium- to long-term interest rates up well before short rates move.

*Minimum 20% deposit, owner occupiers, 6 largest lenders.
Compounding is minor so is ignored.

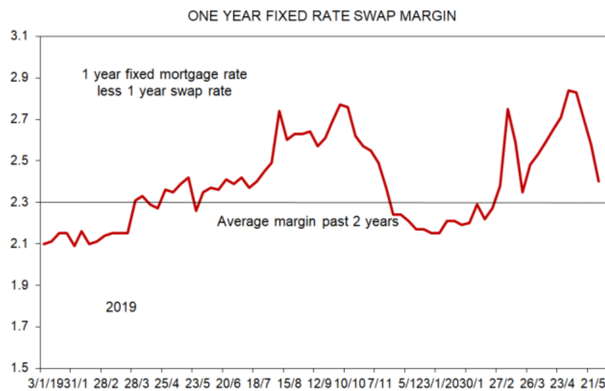


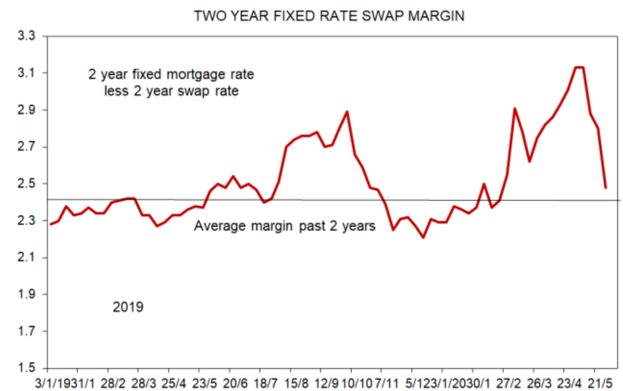


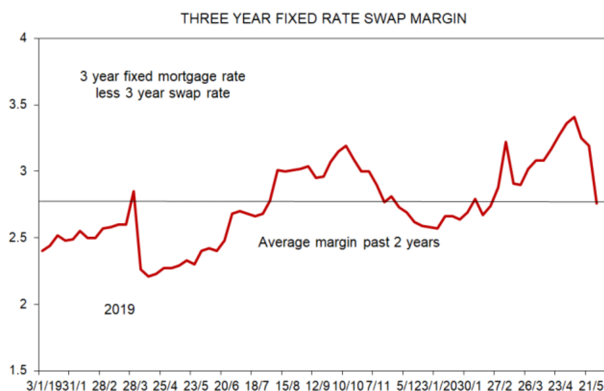
IS A FIXED RATE CHANGE IMMINENT?

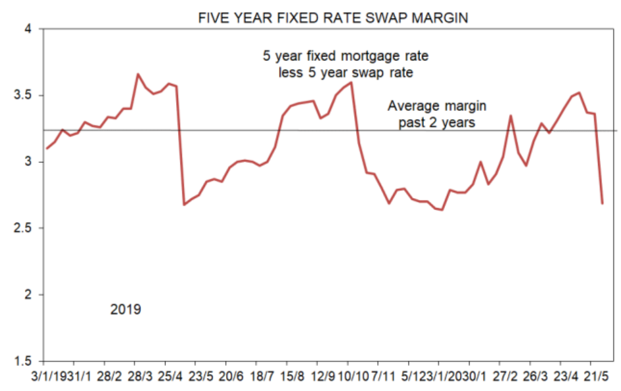
Who'd have thunk it? The analysis here actually worked. Graphs in recent weeks were showing margins well above average. I figured banks would be tardy in cutting rates but that they eventually would. But with pressure from our activist RB Governor the banks have slashed rates. Note the five-year margin. This is one reason why if I were borrowing at the moment, I'd personally be fixing five years.

You can form your own opinion as to whether banks might be about to raise or lower their fixed rates by looking at the following graphs. They compare published fixed rates with the most frequently changing component of the total cost of funds – the swap rate. Note that there are other funding costs which will not be captured here, but they change infrequently. But be warned. There is no real forecasting insight delivered by a thing (equity, exchange rate etc.) moving further from some concept of fair value or average. If a thing is 10% above trend, it might simply be on its way to being 40% above trend.









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