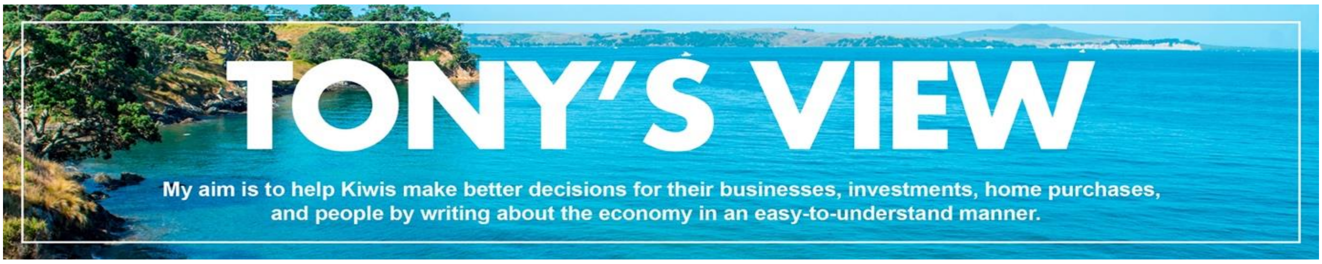

Input to your Strategy for Adapting to Challenges
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In the maelstrom

This is about as bad as it gets. Nothing seems to be going right for the economy, households and businesses, the pressures keep growing, and the Reserve Bank is set to make things worse by raising interest rates another 0.5% next week.

The US economy may already be in recession, data coming out from most countries are very poor, confidence levels here have collapsed, the IRD is bringing down an overdue hammer on firms which have been given a lot of leeway, a new wave of Covid is sweeping the world and there is open talk of a return to a Red traffic light setting in NZ, plus house prices are still falling.

Most of these (not Covid) are good things. The last thing we need right now is for demand in our economy to be bounding ahead because that would mean rising inflation risks and more pressure on resources which simply are not available. We need a period of slow growth in order to buy time for the inflation risk to subside and resource availability to improve.

My key point since receiving the results of my first monthly Spending Plans Survey for 2022 in the first week of February has been that the weakness the Reserve Bank needs to see is happening. Now everyone can see it and that weakness is deepening. That is why interest rates in the wholesale markets have fallen this week and pricing has shifted to the official cash rate peaking below 4% rather than 4.75% at one point.

I still pick a peak of 3.5% but wouldn't rule out the rate actually topping out at my original predicted peak of 3.0%. It is notable this week that some banks have cut their two year fixed mortgage rates because the two year swap rate which they borrow to lend to customers has fallen by over half a percent in the past three weeks.

This is the point in the cycle – assets, economic etc. – where you need to step back from the fray and concentrate less on voyeuristically wallowing in the horror of the news, and more on controlling your emotions. Specifically – don't panic. If you are in the home building sector, then it is too late for you to do much about the construction decline and collapse of partners coming your way. I warned about this over 15 months ago and the time to get prepared disappeared a long time back. You're in for the ride down now.

But for other sectors, look at it this way. This is the worst time to be divesting and there is no strategy you would have developed in the past which could be summed up as – we will enjoy the growth but sell our asset/business when things are at their worst, buyers can't get credit, and sentiment levels are at record lows.

By all means, rein in spending plans, but concentrate on means of boosting productivity through investment, and remember my key message for the past few years. We are now a capacity-constrained economy. You cannot run your business by acquiring customers and then getting credit, capital, premises, staff, and supplies.

You have to first figure out what of these resources you can acquire and retain for the next 5-10 years, then figure out what growth in output that will allow you to achieve. For some businesses the answer is that the current level of output cannot be achieved with the timeliness of delivery and quality of service desired. Also, for SME owners, are you now a slave to your company working 80 hours a week trying to produce a flow of output that you can't sustain if you want to preserve your physical health, mental health, and family cohesion?

You need to look though all of your outputs and ditch the least profitable ones – with profit perhaps measured as those which demand the greatest resources. You need to do the same exercise for your customers and the markets you target, the locations you are in, the production and distribution methods which you use.

I am an economist and that means I have to avoid focussing excessively on where the economy is at currently and look at where things are going. You are not. You live in the current environment and you will be feeling very pressured. You will probably have to make some changes to get through and the best message I can give from my area of expertise and responsibility is this.

The changes needed for a better operating environment for yourselves going forward are already underway. Weakening demand yet rising population will slowly alleviate hiring pressures - but not back to the old pick and choose days. Inflation prospects are improving for 2023, people are doggedly determined to re-embrace their pre-Covid travelling ways, an easing of LVR rules is on its way, mortgage rates have about peaked except for floating and one-year fixed rates, the exchange rate is good, foreign students will return, and our export prices are strong.

What the surveys tell us

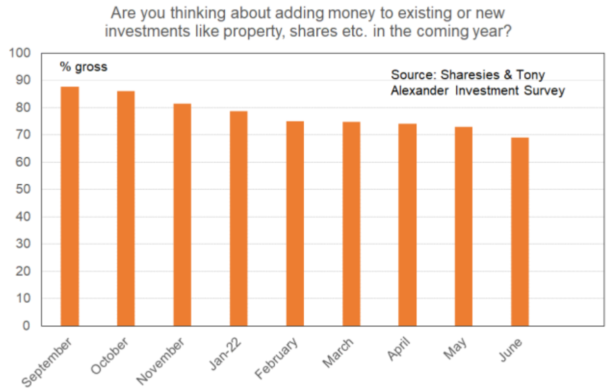
Each week in Tview Premium I include a quick run-through of the main insights provided by the five monthly surveys which I run alongside REINZ, Sharesies, Crockers Property Management, and mortgages.co.nz

Here is that summary for your guide.

Portfolio Investment Survey Sponsored by Sharesies

This survey gives insight into changes in the asset types people are favouring. I'll be using it to track the slow move away from residential property investment. About 1,200 responses.

Investors are showing decreasingly willingness to add to their portfolios, but at a net 69% the proportion planning to do so is still very high.
Crypto asset investment intentions have not been dented by recent price weakness.
Rising interest rates are not leading to a lift in plans for reducing debt levels.
Interest in purchasing shares in the energy sector continues to grow.
Increasing pressures in the residential construction sector are leading to reduced interest in adding to holdings of shares exposed to the sector.

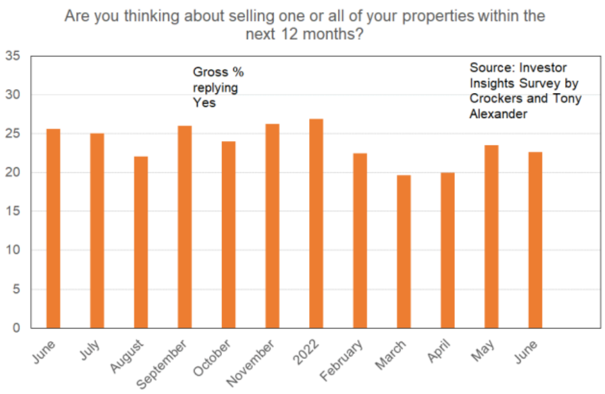


Crockers & Tony Alexander Investor Insight

This survey gives insight into the plans of residential property investors. It delivers insight into the impact of policy and interest rate changes.

- There remains no indication that rising interest rates are causing extra acceleration of debt repayment plans.
- Net intentions of buying more property have eased in recent months but remain consistent with much of the period from June 2021 when our survey started.
- The average term investors are fixing their mortgage interest rate for continues to shorten.
- Landlords no longer on average consider it easy to find good tenants. The trend suggests that soon there will be more landlords finding it hard to get the good tenants they want than will find it easy.

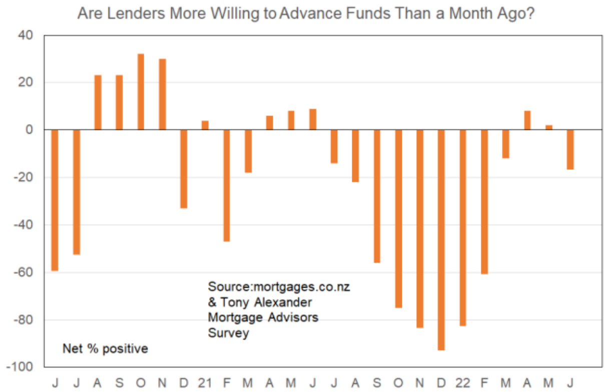
- Intentions of buying a new build or undertaking one's own development are declining.



Mortgages.co.nz & Tony Alexander Mortgage Advisors Survey

This survey gives insight into property demand from investors and first home buyers from the unique position of mortgage brokers. We can also gain insight regarding how banks are changing lending policies towards property buyers. Usually near 70 responses – but just 42 this month.

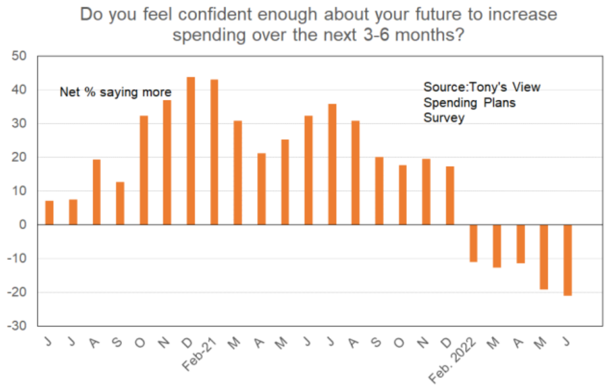
The survey shows continued withdrawal of interest by investors and first home buyers, a slight lift in favour of fixing for one year, and a decline in perceptions of bank willingness to lend amidst rising test interest rates and increasing requirements for surplus monthly income.



Tony's View Spending Plans Survey

This month's survey attracted 1,021 responses and has shown a fall in net spending intentions to -21% in June from -20% in May and an average +25% over 2020-21.

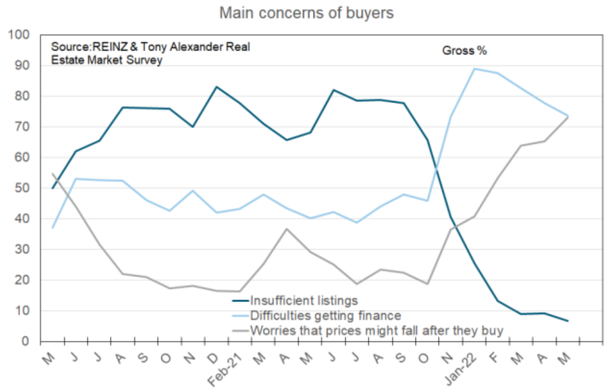
The need to devote more household money to buying weekly groceries is eating into willingness and ability to spend on other things. A record net 29% of people plan cutting back their spending on eating out. Record weakness is also reported in plans for home renovations and buying furniture, technology, clothing & footwear, gardening supplies, online services (subscriptions etc.), sporting equipment, wellbeing services, and a dwelling for one's own use.



REINZ & Tony Alexander Real Estate Survey

The 557 real estate agents responding in our late-May survey of market conditions shows FOMO is dead with only 4% of agents seeing buyers display it. But FOOP is high at 73% while a net 65% are seeing fewer people attend auctions and a net 70% fewer at open homes. Buyers are sitting on their hands and a net 70% of agents say that prices are falling in their location.

Welcome to the downward leg of the housing cycle after the most absurd soaring of prices ever.



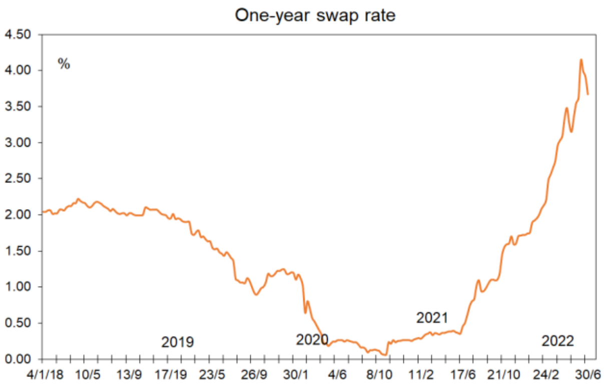
If I were a borrower, what would I do?

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.

Mortgage rates may have peaked for 2-5 years fixed

The deteriorating outlook for the world economy and possibility that the US economy has already recorded a fresh recession in the first half of this year have contributed to some big falls in wholesale interest rates over the past two weeks.

The one year swap rate at which banks in New Zealand borrow money to lend to you and I at a fixed rate for one year has fallen to near 3.67% from 3.91% last week and 4.14% three weeks ago. The three year swap rate is near 3.8% from 4.15% last week and 4.52% three weeks back.



The financial markets in New Zealand are now no longer pricing in the Reserve Bank taking the official cash rate to over 4%. They are not yet picking the 3.5% peak most of us economists are

sitting at, but the way things are going we will see that adjustment happen also in coming weeks.

The aim of the Reserve Bank when raising interest rates is mainly that we consumers rein in our spending. As I have been noting since February, that is happening in spades. The net proportion of people responding in my monthly Spending Plans Survey saying that they intend spending more on things over the next 3-6 months fell to a net 11% negative in February from 17% positive in December and an average +25% for the year and a half ending in December.

Spending restraint is well underway and my most recent survey shows it is continuing. I will write up the results of this month's survey over the weekend and send them out probably on Monday. Suffice to say, they do not paint a pretty picture for the retailing sector.

My current expectation for the one-year fixed mortgage rate in July 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 averages	
2022	5.19		5.19	1 yr
2023	5.75	5.47	5.39	2 yr
2024	5.00	5.31	5.89	3 yr
2025	4.25	5.05	6.05	4 yr
2026	4.00	4.84	6.19	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 5.47%, three years 5.31%, four years 5.05%, and five years 4.84%.

If I were a borrower, what would I do?

Because of the sharp fall in the cost to banks of borrowing money at a fixed cost to them for two years we have seen some pare back their two year fixed mortgage rates charged to borrowers. But this does not change the minimum rate which was already in the market amongst the five lenders I track and that means no changes in my table just above.

I have commented recently that fixed rates for periods of two years and beyond have either reached their peaks or sit very close to their peaks. I remain of that view and would not rule out further small rises from here if economic data surprise on the strong side while central banks are still pushing their cash rates higher.

But any rises will likely be minimal and that just reinforces the fact that fixing long now would involve fixing at or near the top of the rates cycle – that is no a good idea. If you did not fix five years at 2.99% last year when I so strongly advocated that term, why would you now fix five years at 6.19%, or four years at 6.05%, or three years at 5.89%?

What about two years at 5.39%? This will suit most people and almost certainly take one through to the easing leg of the monetary policy cycle. I'd probably fix one year if borrowing at the moment but it's a close call with two years.

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

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]

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