BRAMWELL BROWN LTD

INVESTMENT ADVISERS – SHAREBROKERS

Director: Brett Dymond – BBS, GradDipBusStud (Personal Financial Planning)

Bramwell Brown Limited – Newsletter – September 2022

What is the Official Cash Rate, and How Does it Work?

The Official Cash Rate (OCR) is a tool used by the Reserve Bank to influence monetary conditions in the economy. The Reserve Bank is charged with maintaining a sound and efficient monetary and financial system by managing inflation to keep prices stable, while supporting maximum, sustainable employment. Specifically, the Reserve Bank's objective is to keep future annual inflation between 1% and 3%, with a focus on keeping future inflation near the 2% mid-point.

In broad terms if inflation is high the Reserve Bank will increase the OCR to slow the economy. In contrast, if inflation is low they will reduce the OCR to encourage economic activity. We have seen this in action since the Global Financial Crisis in 2008-2009. At that time the OCR was 8%. When the financial crisis unfolded, governments all over the world reduced interest rates in an effort to mitigate the impact of the crisis on the economy. Interest rates remained low for a decade. Unfortunately Covid added fuel to the fire, creating another round of reducing rates. Low interest rates encourage spending, as it is cheaper to obtain credit. We can see this in our housing market – low mortgage rates have created a house-price explosion. In hindsight you could argue our Reserve Bank reduced the OCR too far, and for too long.

The registered banks hold settlement accounts with the Reserve Bank, which they use for inter-bank transactions. At the start of each day a bank is unsure how much money will be withdrawn or deposited by its customers. There are millions of inter-bank transactions every day, and at the end of the day individual banks will end up in credit or overdrawn. The Reserve Bank will cover the unders and overs by either charging or paying interest to the banks, depending on whether they are in debit or credit. The interest rate charged by the Reserve Bank for debit balances, or paid for credit balances is closely linked to the OCR. There is no limit on how much the Reserve Bank will borrow or lend.

Because of the settlement function provided by the Reserve Bank, the OCR has the ability to influence short-term interest rates. The registered banks are not going to lend money to customers for rates that are less than they are being charged by the Reserve Bank. Longer-term interest rates are also affected by the OCR, but to a lesser degree. Estimates of future rates of inflation, together with overseas interest rates affect our longer-term rates more than the OCR.

Latest Official Cash Rate Announcement

In their August meeting, the Monetary Policy Committee increased the Official Cash Rate (OCR) to 3.00 percent from 2.50 percent. Here is the Monetary Policy Statement.

Demand in the New Zealand economy remained resilient to global and domestic headwinds over the first half of 2022. Household spending is holding up, despite low consumer confidence and high inflation. Overall, household budgets have been bolstered by high levels of employment, savings built up during COVID-19 lockdowns, and government support payments. A significant increase in international visitor arrivals following the reopening of our border has likely boosted demand in the tourism and hospitality sectors. Labour and materials shortages are holding the economy back and adding to inflation. The unemployment rate remains very low at 3.30 percent. The New Zealand economy is being constrained by acute labour shortages. A wide range of indicators continue to point to employment being above its maximum sustainable level. Higher-than-usual levels of sickness from COVID-19 and other illnesses, as well as an outflow of New Zealanders heading overseas following the reopening of our border, have made labour shortages worse. A very tight labour market is adding to high consumers price index (CPI) inflation, with wage growth continuing to increase as businesses compete to attract or retain staff. However, this growth in wages is still being outpaced by the rising cost of living for many New Zealanders. Global and local supply-chain bottlenecks are limiting and slowing down production, making goods more expensive and further constraining output. The war in Ukraine and COVID-19-related lockdowns in China are adding to these bottlenecks.

House prices have continued to fall towards more sustainable levels, and the outlook for residential construction has weakened. We expect house prices to decline further over coming months. Construction sector activity has remained at a high level, but the outlook for residential construction has weakened. The combination of acute labour and materials shortages in the construction sector has constrained activity and contributed significantly to domestic inflationary pressure. Future work orders have begun to dry up beyond construction firms' existing work pipelines. Higher interest rates, tighter lending conditions, and rising costs are weighing on demand. Higher interest rates are needed to meet our inflation and employment objectives. Annual CPI inflation has continued to increase, reaching 7.3 percent in the June 2022 quarter, due to a mixture of domestic and international factors. Measures of persistent or 'core' inflation have also increased. Expectations for inflation have eased recently but remain elevated relative to history. The Monetary Policy Committee expect they will need to increase the OCR by more than expected in May to return inflation to the 2.00 percent target midpoint, and employment to its maximum sustainable level. The Committee agreed it remains appropriate to continue to tighten monetary conditions at pace to maintain price stability and contribute to maximum sustainable employment. Core consumer price inflation remains too high and labour resources remain scarce.

Markets

Share markets continue to be volatile. A recovery throughout August has been largely erased by a fall at the end of the month following a speech by the United States Federal Reserve chair Jerome Powell, stating they would likely need to keep interest rates high enough to slow the economy “for some time” in order to beat back the high inflation sweeping the country. Most of the research I’m reading has an expectation of gradual increases in interest rates into 2023, before stabilising in 2024. Of course, economic predictions tend to be just as volatile as the indicators they are trying to predict. The Covid 19 pandemic and the war in Ukraine are examples of events that are impossible to predict, yet have significant effects on our market and economy.

Interest Rates

One good outcome of the increase in the OCR is for those relying on fixed interest investments to supplement their income. Bank deposit rates and bond rates have been increasing gradually over the last year. Here is a summary of some of the bank term deposit rates on offer at present. The top line shows the rates available in February 2021. The rates underlined and in bold are the current rates.

	1 Year	**2 Years**	**3 Years**	**4 Years**	**5 Years**
ANZ	0.80%	0.85%	0.90%	0.90%	0.90%
ANZ	**4.00%**	**4.20%**	**4.30%**	**4.40%**	**4.50%**
ASB	0.75%	0.80%	0.90%	1.00%	1.00%
ASB	**4.00%**	**4.10%**	**4.35%**	**4.40%**	**4.50%**
BNZ	0.80%	0.85%	0.85%	0.90%	0.90%
BNZ	**4.00%**	**4.10%**	**4.35%**	**4.40%**	**4.50%**
Heartland	1.00%	1.00%	1.05%	1.00%	1.00%
Heartland	**4.20%**	**4.10%**	**4.20%**	**4.30%**	**4.40%**
Kiwibank	0.90%	0.90%	0.90%	0.90%	0.90%
Kiwibank	**4.00%**	**4.10%**	**4.20%**	**4.25%**	**4.30%**
Rabobank	1.00%	1.00%	1.05%	1.05%	1.15%
Rabobank	**4.07%**	**4.27%**	**4.46%**	**4.60%**	**4.65%**
Westpac	0.80%	0.85%	0.85%	0.90%	0.90%
Westpac	**4.00%**	**4.10%**	**4.30%**	**4.40%**	**4.50%**

Portfolio Administration

Are you having trouble with the share registries sending your financial information via email rather than post? Are you spending hours searching for financial information for your accountant at the end of each financial year? If so Bramwell Brown can help. We offer a portfolio administration service where we handle all the mail associated with your portfolio and liaise with your accountant at the end of each year. Call the office if you would like to discuss this service.

Bond Yields

Here is a selection of the current yields on commonly traded bonds listed on the New Zealand Exchange. I've included the July 2021 yields (where applicable) to show some comparison. You can see in many cases the current yield is now greater than the coupon rate – something we haven't seen for a number of years.

Company	Coupon	Maturity Date	Yield July 2021	Current Yield
Infratil	5.50%	June 2024	2.75%	5.65%
Precinct Properties	4.42%	November 2024	2.04%	5.18%
Kiwi Property Group	4.33%	December 2024	1.83%	4.73%
Synlait Milk	3.83%	December 2024	4.50%	8.35%
Infratil	4.75%	December 2024	2.90%	5.30%
Wellington Airport	5.00%	June 2025	2.15%	4.53%
Infratil	6.15%	June 2025	2.50%	5.50%
Summerset	4.20%	September 2025	2.22%	5.30%
Property for Industry	4.25%	October 2025	2.20%	4.80%
Argosy Property	4.00%	March 2026	2.10%	5.45%
Infratil	3.35%	March 2026	2.89%	5.80%
Manawa Energy	3.35%	July 2026	2.30%	5.35%
Infratil	3.35%	December 2026	2.85%	5.85%
Ryman Healthcare	2.55%	December 2026	2.35%	5.49%
Goodman Property Trust	4.74%	April 2027		5.19%
Sky City Entertainment	3.02%	May 2027	2.50%	5.83%
Precinct Properties	2.85%	May 2027	2.55%	5.62%
Vector	3.69%	November 2027		5.30%
Infratil	3.60%	December 2027	2.95%	5.80%
Arvida	2.87%	February 2028	2.70%	5.65%
Precinct Properties	5.25%	May 2028		5.20%
Infratil	4.85%	December 2028	2.70%	5.35%
Manawa Energy	3.97%	February 2029	2.15%	5.00%
Infratil	5.93%	June 2030		5.60%
NZX	5.40%	June 2033	2.75%	5.20%
Genesis Energy	4.65%	July 2048	2.08%	5.35%
Mercury Energy	3.60%	July 2049	2.10%	5.30%
Genesis Energy	5.66%	June 2052		5.65%