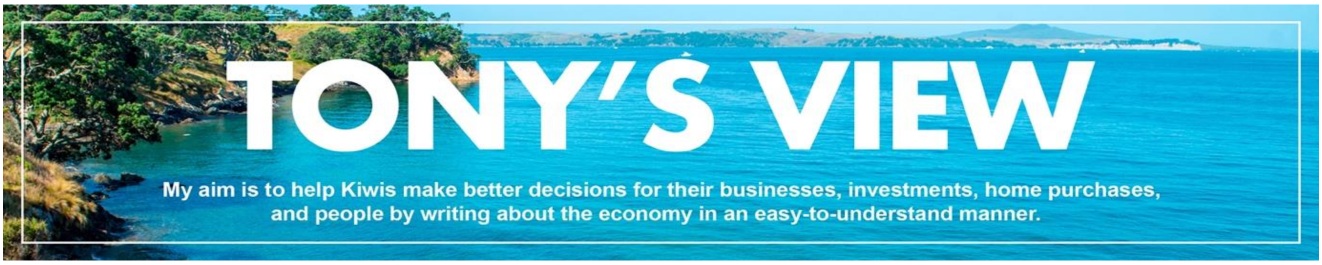

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Rate cut impact evident

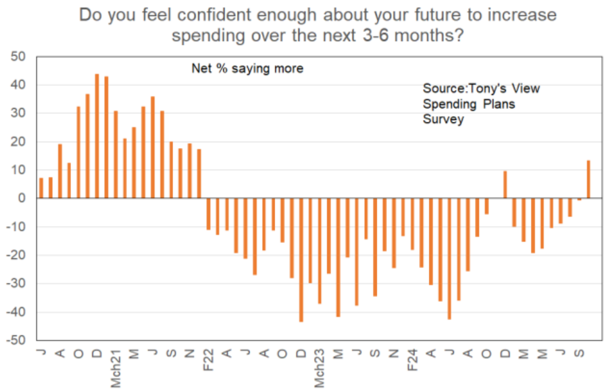
This week the main thing I want to write about is the set of results from my monthly Spending Plans Survey. They are about one week later than usual because I wanted to see if there would be any impact from the Reserve Bank's cash rate review outcome on the 8th. There is.

Back in the middle of last year when the economy was in the process of shrinking 2% over a six month period a net 42% of my survey respondents said that they planned cutting back on spending in the coming 3-6 months.

That reading jumped to an overly optimistic net 10% positive in December as people responded to the easing of monetary policy which started on August 14.

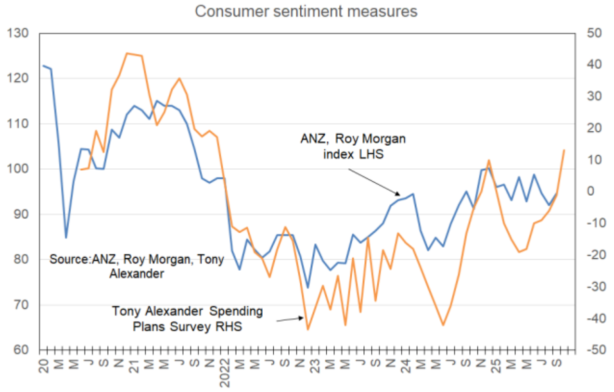
The reading then fell away to -18% in April this year as people realised the simple removal of high borrowing costs was not going to drive the economy greatly forward and bring good jobs growth and rising wealth through higher house prices.

But after that April result the readings started to slowly improve and reached a near four year high (excluding December last year) of -1% in early-September. Now, following last week's cut in the official cash rate from 3% to 2.5% the net reading has risen to +13%.



This is the best result since December 2021 and bodes well for a turnaround soon in the sad fortunes of a retail sector whipped to pieces by the pandemic binge and then its aftermath.

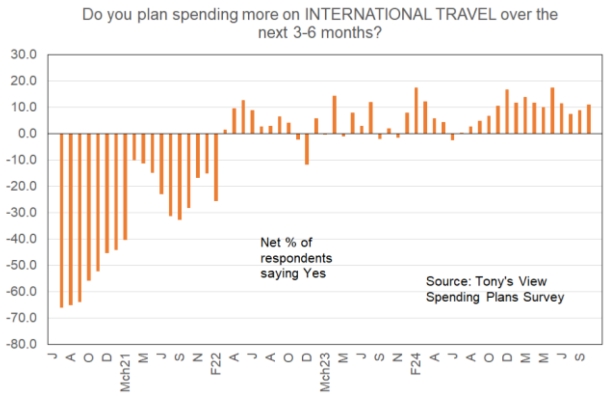
This graph shows the broad correlation between my measure and the ANZ Roy Morgan gauge which will come out later this month. It will probably jump up and elicit some attention in the media and markets whereas I prefer to go under the radar these days reaching just my subscribers.



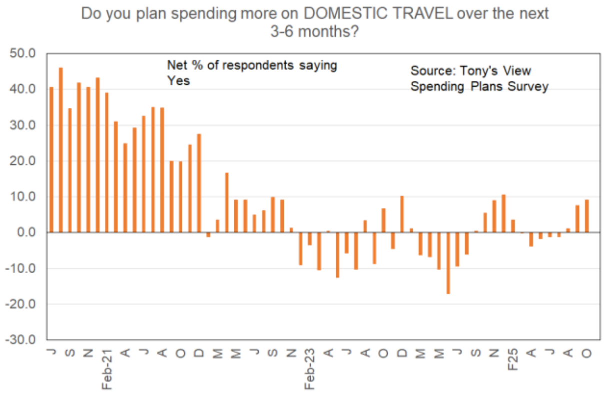
Now let's look at the net responses to individual items like spending more or less on travel, eating out etc. This table shows the net proportion of the respondents planning to spend more in the areas listed. We can see strong spending plans for home renovations, offshore travel, domestic travel, and shares. Groceries are strong because of rising prices.

	Net % respondents planning to spend more
General groceries	22.4
Home renovations	16.6
International Travel	10.8
Domestic Travel	9.1
Shares	7.9
Gardening tools, plants etc.	4.9
Wellbeing/self-improvement	-0.3
Dwelling for own use	-3.1
Technology (PCs etc.)	-5.2
Furniture or appliances	-5.9
Eating out	-6.5
Investment property	-6.5
Motor vehicles	-7.2
Sporting/fitness equipment	-7.3
Clothing/footwear	-8.6
Online services	-10.8

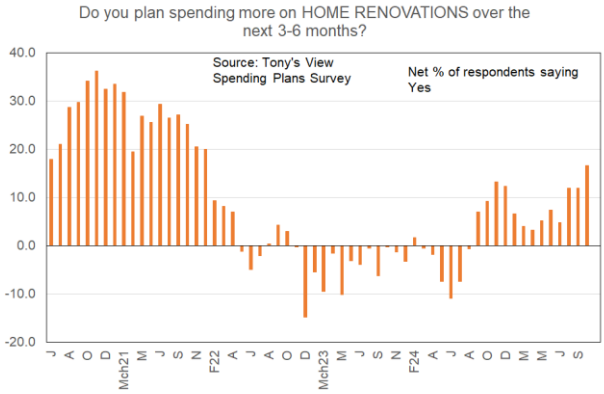
Weakness still exists for many areas, but the graphs below let us see what the trends are, starting with the travel measures. Plans for offshore travel are about as strong as they have been for some time. Lower interest rates don't seem that relevant here – meaning high interest rates probably were not a big driver of earlier weakness.



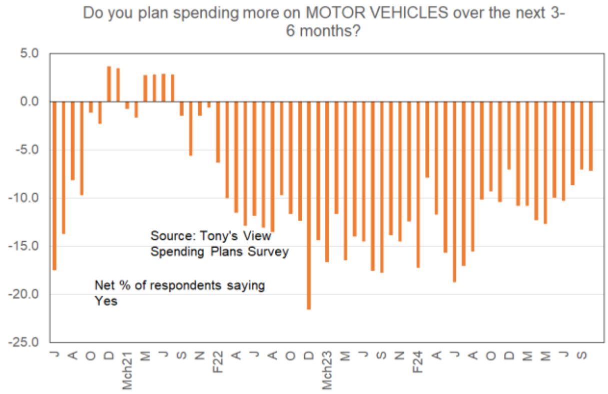
Also, plans for domestic travel rose well ahead of last week's extra interest rate cut. But the notable drop in plans right after the shock 0.75% tightening in November 2022 and Reserve Bank warning of recession shows monetary policy does matter for domestic holidaying if not international jaunts.

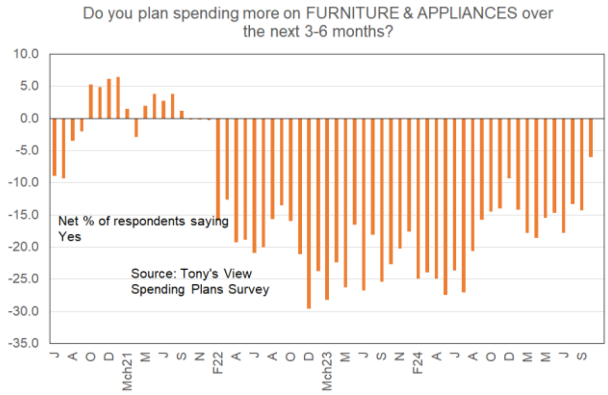


The home renovation sector has had an improving outlook since right after monetary policy started easing last year. Interest rates matter for this area of lumpy spending with levels of stress not accompanying other big purchases like cars and furniture. The latest rate cut has delivered an extra boost to this sector with the reading near a four year high.

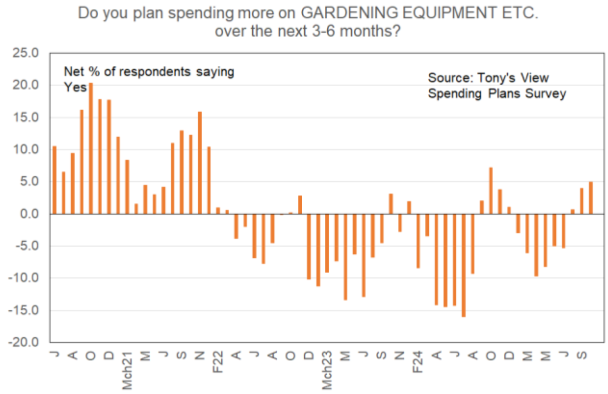


Speaking of cars and furniture, no improvement is evident this month for the former, confusing as the issue is with electric vehicles and petrol costs involved, but plans have improved a lot for furniture and appliances. Too late for Smiths City Market, however.

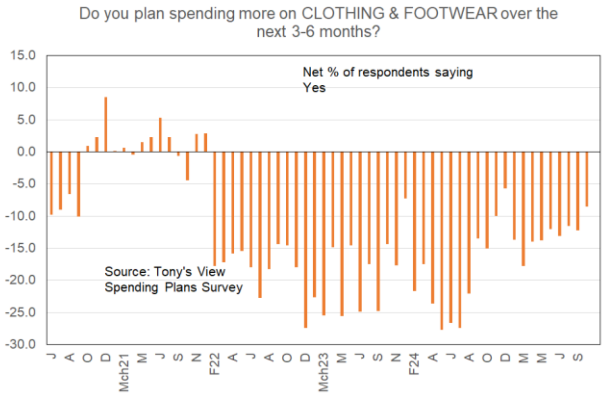


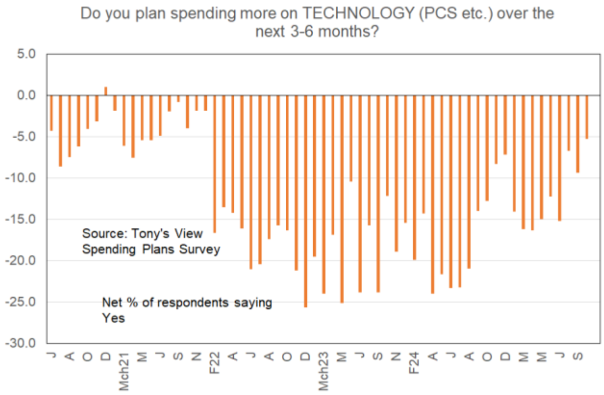


There is improvement evident for gardening. But frankly, this looks merely seasonal.

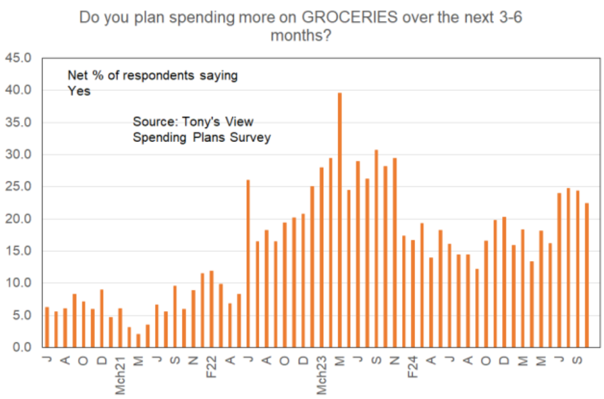


There is less weakness ahead for clothing and technology.

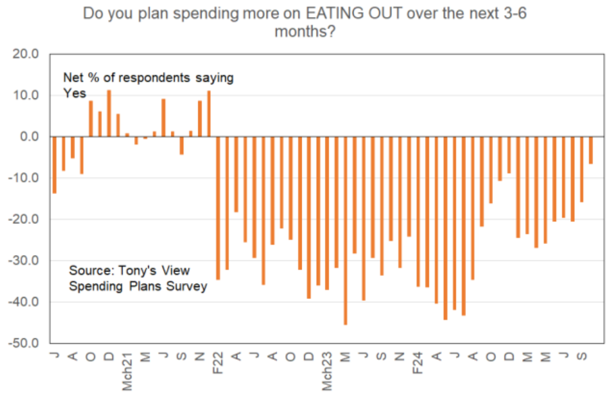




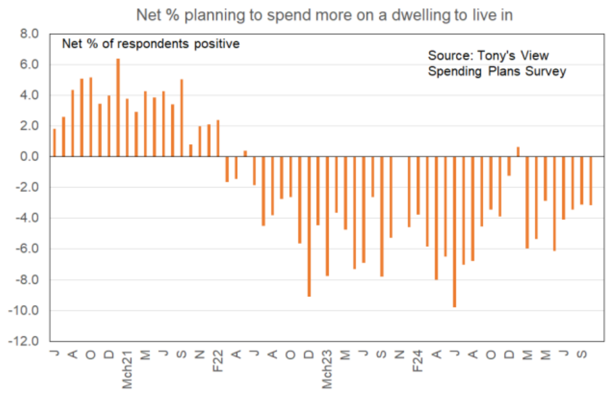
For groceries there is no easing yet in our concerns about higher prices is my interpretation of the graph.



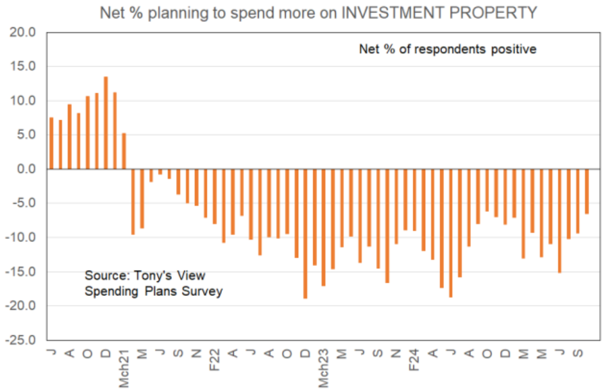
For cafes and restaurants that are still in business, you are on the cusp of being rewarded.

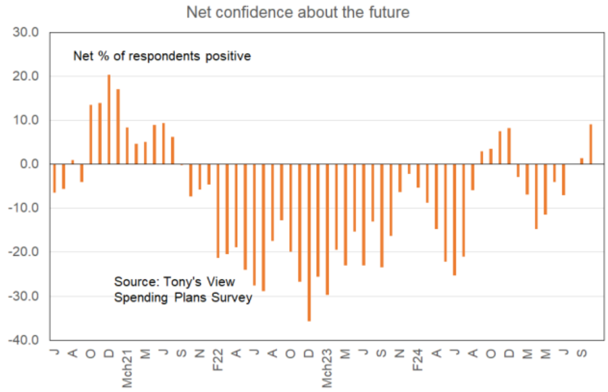


On the housing front we can see that the rate cut has not produced an immediate improvement in buying intentions for those looking to live in the purchased property. Conditions remain weak and that is probably because of the high employment uncertainty affecting existing owner occupiers.

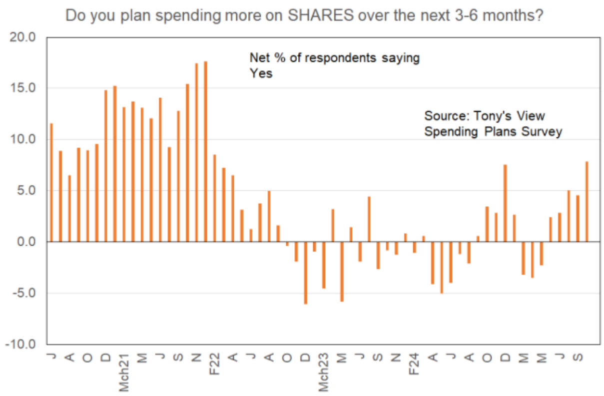


For investors however there is some improvement recorded this month which continues the trend in place since August. But the situation still looks a tad weak.



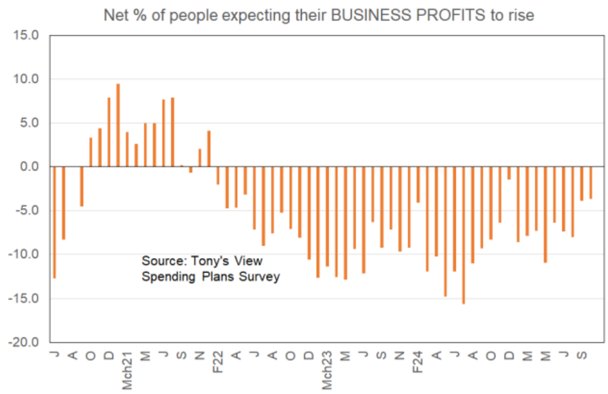


Finally, for shares we see a strong gain in net buying intentions over the month. This will likely reflect the strength in the US sharemarket (most responses were in before the 2% Dow fall on Friday), and the simple asset substitution effect of lower interest rates.

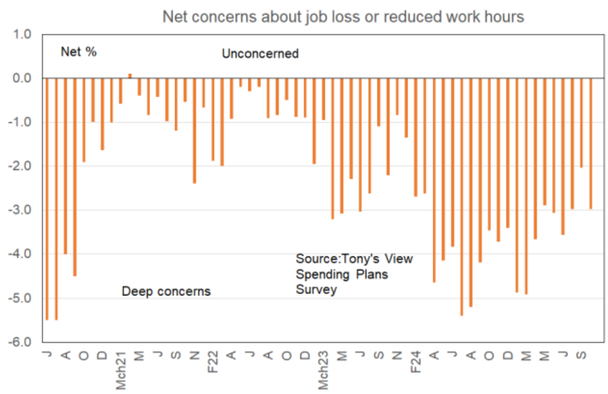


From my survey we can also gain information on the factors which are affecting people's willingness to spend. Specifically, we can see that confidence about the future has just turned up. It will be interesting to see this pan out in the political opinion polls next year.

Business expectations for their profits have improved in the past couple of months but still look subdued.



Finally, here is a graph which allows us to get a feel for whether or not people feel secure in their jobs. They do not. It will be interesting to see the strength of the boost in retail spending when this factor starts turning around next year.



Inflation is not under control

The economy has shrunk by 1.1% over the past year while job numbers have fallen 0.9% and the unemployment rate has risen from 4.7% to 5.2%. The capacity utilisation rate captured in last week's quarterly survey from NZIER is below its ten year average by 2%, and 63% of businesses versus 47% average say lack of customers is the reason they can't grow output.

Yet the inflation rate is 2.7% compared with an average since 1992 of 2.3%. The economy since 1992 has grown on average 2.9% with jobs growth averaging 2% a year.

The Reserve Bank are predicting that over the years to March 2027 and 2028 our economy will grow 2.7% and 3.0% with employment rising 2.6% and 2.3%.

But the inflation rate is seen falling to 2.1% and 2.0%.

The last time inflation was 2% was during the first year of the pandemic and before then when the world was gripped by worries about deflation and negative interest rates.

Things do not add up. There is a world in which everything will go well, and growth will surge while inflation falls. It's the one where you replicated Torvill and Dean's Bolero and bought Bitcoin when it was a dollar.

Counting on a major turnaround in the pace of economic growth and inflation falling is a very risky bet to take when the economic models used for predicting growth and inflation have not delivered accurate insights for many years, and when shocks both domestic and international have become more frequent.

I'd give a 5% probability to the Goldilocks scenario predicted by the Reserve Bank coming true with that probability cut from a couple of weeks ago because of the extra easing of monetary policy which they are now undertaking.

This easing will eventually boost growth in a traditional lagged manner. But so too will growth be boosted by the lagged effect of higher farm incomes plus the lagged effect of recent weakness in the NZ dollar.

The outlook for growth over 2026-28 is good. But I question the ability of the Reserve Bank to keep inflation comfortably within the 1% - 3% target band and worry that a rapid tightening will occur further down the track.

That is why I am a fan of fixing one's mortgage for a five year period at 4.99%. I'd invite those who chased the brightly striped candy of a 2.29% one year rate in 2020-21 and ended up paying 7.49% come 2023 to think about how that felt. They could have avoided all that by fixing five years over 2020-21 at 2.99%.

Had they done that then right now they'd be rolling off 2.99% onto something below 5% and I'd like to think those who locked in five years back then will seriously consider doing so again. I would, even though the upside interest rates threat looks less going forward this time around.

What will happen? Almost everyone will fix close to 12 months.

If I were a borrower, what would I do?

Wholesale interest rates have edged slightly lower this week in response to some easing in US rates. The lowering of US rates reflects the reigniting of the trade war between China and the United States and a reminder to all that deep uncertainties remain about the operating environment ahead of many businesses and economies.

Beyond that anything I've got to say was covered in the section just above regarding the low probability of our growth rate jumping from -1% to +3% and inflation comfortably falling.

If I were borrowing at the moment I would look to fix for five years at 4.99%. The rate is relatively low and would give high protection against the risk I see of extra tightening of monetary policy from late-2027 because of the extra easing having to be undertaken now as a result of the weaker than expected economy.

Having said that, I could not fault people fixing for just one year or thereabouts because the cash flow advantage is good and worth having for many at a time when many other costs are rising. Just remember the 5% jump in short term fixed rates last tightening cycle from 2021-23.

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

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.