

## Input to your Strategy for Adapting to Challenges

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## Enjoy summer

**Merry Christmas everyone and welcome to my last weekly for 2025. The first for 2026 will probably appear on January 15.**

Ever since August last year when a journalist said that falling interest rates would deliver a “rockstar” economy I have hammered two themes. First, that 2025 would not be the bountiful surge many were expecting and disappointment would abound.

Repeatedly I listed the many reasons why growth would not be strong but noted the year would still be better than 2024 for most even though a lot of weeding out would still continue across all sectors of the economy.

I am happy with what I wrote and spoke about as this year has turned out to be a disappointment for many, and I hope the warnings prevented a few businesses from committing cash flows to an upturn too early.

Second, I have been warning since August 2024 that inflation is not beaten and optimism regarding interest rates should be kept in check. I would often reference the way business margins have been crunched and the way the eventual return of


customers would produce a fresh surge in prices in order to recover higher costs.

I reckoned the Reserve Bank would cut the official cash rate from the 5.5% it was at until early August 2024 to about 3-3.5% come 2026. The market range of predictions back then was 2.75% to 3.5%. In the event they have cut to 2.25% before the end of this year as the economy has proven even less rockstar-like than anticipated.

I’ll give myself an A on the weak economy call and B on the interest rates side with that latter rating assisted by my hammered preference recently for fixing five years at 4.99% rather than staying with the short terms I discussed from August last year.


In particular, while many have been surprised by the recent surge in bank wholesale borrowing costs (swap rates) and upward movement in medium to long-term fixed mortgage rates I am not.

Fixed rates always change well ahead of changes in floating rates as the markets anticipate what will happen. Those anticipations both here and offshore have been transitioning in recent months




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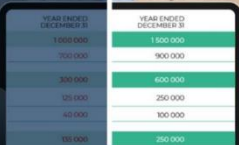
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away from forecasts of further rate cuts towards forecasts of rate rises. This has particularly happened in Australia and the rises in our wholesale interest rates are close to what has happened over there as the markets talk about the Reserve Bank of Australia taking its 3.6% cash rate up in February.

Which brings me to my interest rates warning again for New Zealand. The Reserve Bank are predicting that as a result of the rate of growth in our economy accelerating from -1.1% to near 3% and job numbers rising after falling 0.6% this past year, our inflation rate will decline from 3% to sit calmly at 2%. It doesn't add up.

This is especially the case when we consider that business pricing plans as measured in the ANZ's monthly Business Outlook survey are running at twice the level consistent with the 2.3% average NZ inflation rate since 1992.

The Reserve Bank have probably done again what they have done in the past – eased too late then eased too much. This has come after tightening too late then tightening too much. They are consistently wrong.

For business borrowers with rates from their bank priced off the wholesale yield curve the low point for this cycle was the second half of October. Rates are up about 0.7% since then but there is probably still good value in fixing 3-5 years for most borrowers – businesses and households.

At some point I will switch back to saying I'd refrain from locking in 3-5 years and stay short because those medium to long rates would have risen too much. History tells us all that it is impossible to credibly predict when that point will come.

Actual tightening of monetary policy by the Reserve Bank will almost certainly occur before the end of 2027. The real question is will it occur before the end of 2026? I feel the information to make that call is not in hand yet – but that will be the drift in analysis one suspects as the pace of growth in our economy accelerates.

In particular, keep an eye out for tightening of the labour market earlier and to a greater degree than people are probably not even thinking about at the moment.

I can see from the monthly business survey which I run with sponsorship from MintHC that businesses are lifting recruitment spending and already finding staff harder to source.



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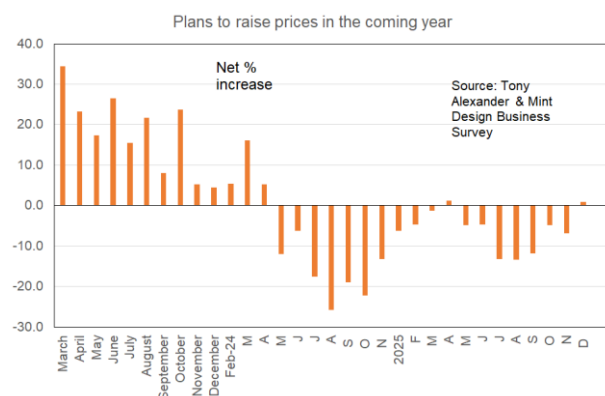
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I can also see an upward trend in pricing intentions, but it is pretty mild as yet. Watch this space, however.



What is a reasonable view which the average investor, businessperson, and home buyer could have for 2026? Improving economic activity which will deliver good jobs growth. Slightly rising house prices with restraint from a continuing structural downward shift in net investor demand for residential property. That is, more investor buyers but a lot more sellers.

Improving residential and non-residential construction including infrastructure work.

Improving retail sales, but as always ongoing structural changes in the sector as we fickle consumers chase the latest shiny thing and exciting store.

I've no view I'd put money on regarding what the NZ dollar will do. Best guess = upward because of rising expectations for monetary policy tightening.

The general election late in the year will crimp economic activity and especially business

investment and investor property purchases from the middle of the year.

## Some random comments

For your guide, many people when discussing the cyclical pickup in the net outflow of Kiwis to Australia talk in terms of it being impossible for a young person to buy a house in New Zealand. Actually, according to Cotality on average 21% of house purchases are made by first-time buyers.

These young buyers have increased their presence in the market since early-2023 and recently accounted for a record 28% of sales. It is not accurate to say that young people cannot buy a house and that this explains why they are leaving.

In fact, for anyone running that argument it would pay to check out the situation in Australia. The days of good housing affordability – usually spoken about in the context of a house and section in South East Queensland (SEQ) – seem to be fairly much gone.

House prices have risen strongly in this previously potentially under-priced part of Australia's housing market and construction is failing to keep up with demand. That growth in demand is driven by net internal migration of people, both young and old, to SEQ for lifestyle reasons.

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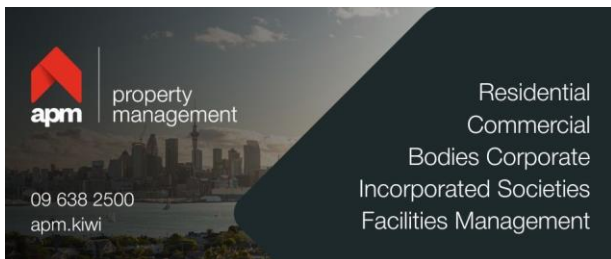
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Many young people probably shift to Australia for higher wages. Analysis of motivations for movement or uselessness of doing so focus very much on money factors. I think they miss the big factor. Freedom.

That is, getting away from the people one has grown up with - family, social settings, workmates, whatever. Australia to us Kiwis represents freedom and opportunity and that easily trumps potential relativities of wages etc.

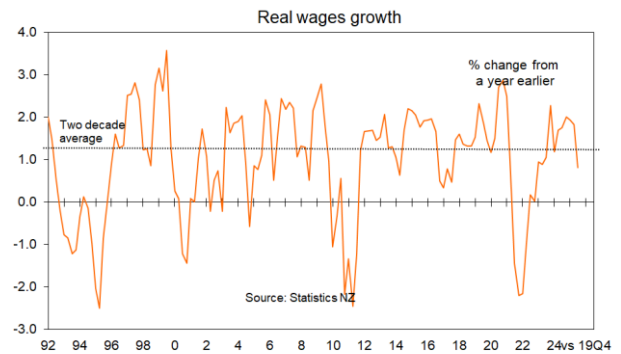


Having said that there is evidence that the relative state of our labour markets matters and with our unemployment rate at 5.3% and Australia's rate 1% lower, it seems reasonable to expect the high net outflow to continue through 2026 but with a slow easing likely to be underway through the year as our economy improves.

Another thing I'd like to mention is the refrain that wages are not keeping up with inflation in New Zealand. This also is not true.

The traditional measure for wages growth in New Zealand is the change in ordinary time average hourly earnings captured in the Quarterly Employment Survey released by Statistics New Zealand.

Since the end of 2019 this measure has risen by 32.5%. The cost of living as measured by the basket of goods making up the Consumers Price Index has risen 26.3% over the same period of time. So, in the past six years average real wage earnings have risen 6.2% or about 1% a year.



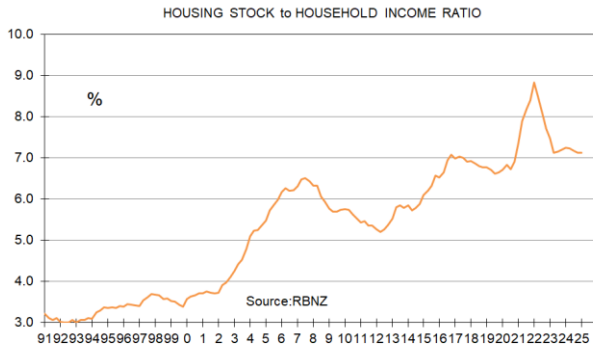
Real wages are rising. People on average are not getting poorer though as happens all the time including during booms, some people are not keeping up. Note that the wages growth measure I have used is per hour. If we instead look at the total wages income of people, we find this amount is up 47.3% since the end of 2019.

A further point I'd like to make is around the comment that New Zealanders have a special relationship with housing and that is why it accounts for a high proportion of household wealth. No we don't.

What we have is a lack of desire to sacrifice current for future consumption – meaning we save very little. That means our stock of financial assets relative to income is low by standards offshore.

But still the claim is made that we over-invest in housing. No we don't. We under-invest in housing as measured by production of new houses. We could usefully have more of them, not fewer.

The claim of over-investment made by some is their way of trying to understand why the ratio of house prices to incomes has climbed so much in the past three decades. This graph is one measure of that rise showing a simple comparison of the value of the housing stock versus household disposable incomes. There are better measures, but the pictures are similar.



Actually, the climbing of this measure reflects imposition of restrictions on the availability of land to build on, lack of productivity growth in the construction sector (a global phenomena), and soaring costs of construction (again, a global thing and not specific to NZ). Note that materials prices continue to climb according to lists of such which people in the building sector kindly forward to me every now and then.

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Plus, people seem to want to live where other people are already living and happy to remain – near city centres in particular.

Last time I looked housing was considered something special by all people around the world. We are not special.

## If I were a borrower, what would I do?

Well, if I were still a borrower I'd have rolled off a 2.99% five year rate locked in sometime between May 2020 and April 2021 and locked in again at 4.99% for five years. I'd probably have broken the rate ahead of April next year to secure the 4.99% or would be doing so very quickly atm.

But most Kiwi borrowers have been riding the one-year roller coaster from 2.29% back over 2020-21 up to 7.4% come early-2024 and now 4.5%. These people will probably continue by and large to stay short with their term preference and act confused and angry when the rate bumps up at least 2% again this cycle.

If I were borrowing at the moment, I'd probably look at the three year rate because the jump now from fixing one year near 4.5% to five years near 5.29% is a bit much to realistically expect much borrower uptake.

With regard to the round of media interviews this week undertaken by our new central bank Governor, her comments are useful in reminding markets that just because interest rates have stopped going down doesn't mean they now go up in the near future.

It will be some time before the Reserve Bank feels a need to impose monetary restraint and their established history of tightening too late then by too much places the timing for the first cash rate rise in 2027 and not 2026.

But remember, fixed rates always move ahead of floating rates because they reflect policy expectations. Those expectations can sometimes shift violently – as we have just seen.

Happy Christmas everyone and I hope you all get a chance for some sort of a rest.



To see the interest rates currently charged by major lenders go to [www.mortgages.co.nz](http://www.mortgages.co.nz)

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