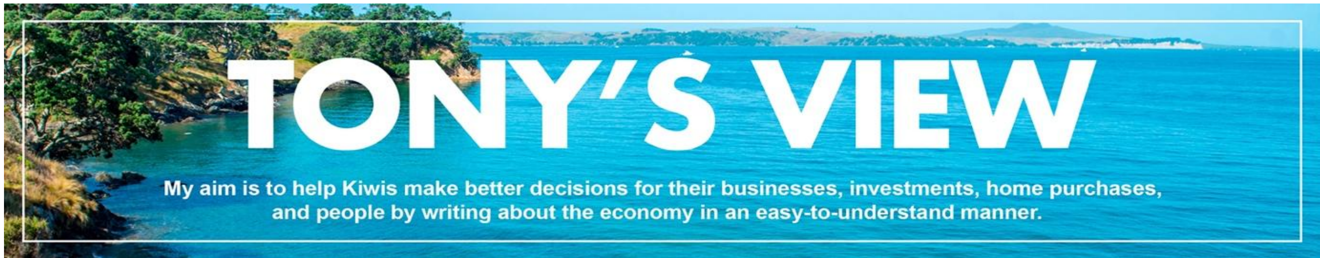

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ISSN: 2703-2825 19 December 2024
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Merry Christmas

Merry Christmas and Happy New Year everyone. This is my last issue of Tony's View for 2024 and the first issue for 2025 will appear on January 16 - probably.

This year started off looking not too bad but then spiralled into a new downturn over the June quarter before some rapid cuts in interest rates brought hopes in many quarters that a strong upturn will occur over 2025 with continuing extra interest rate stimulus.

I always expected 2024 to be a year of "weeding out" involving many over-optimistic, under-capitalised, non-reforming businesses across all sectors closing down because they would not have sufficient cash flow to get through to the recovery. But the period of weeding out due to monetary policy restraint was made a lot worse in response to a range of shocks.

Job insecurity

People and young people in particular I suspect lost confidence in their continued employment. At the start of the year only 14% of real estate agents in my monthly survey said that buyers were worried about their incomes. The average is 20% so things looked good. But this measure rose to 37% come March then 55% in May. It now sits slightly lower at 44%. Job security has gone for many.

Soaring rates and premiums

At the same time the older cohort of our population received a fresh shock in the form of soaring council rates and insurance premiums. Many people are having to reassess their retirement plans including how much they have spare for new items and holidays, and even whether they can afford to stay in their current houses. Competition for entry-level housing has been intense these past couple of decades as investors have competed with first home buyers. Now that competition may intensify anew as some older people downsize earlier than planned and to a greater degree than planned.

IRD catchup

Some business cash flows received a shock from the IRD chasing up old debts now that the pandemic is well behind us. Also, around the

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world it looks like excess savings built up during the pandemic have all but disappeared as a factor helping to insulate against the effects of high interest rates.

Public servant reality check and new interest rate worries

The government also embarked on some long-overdue downsizing of our bloated public sector. Quite importantly, early in February the economists at a major bank predicted monetary policy would need to be tightened another 0.5% and in May the Reserve Bank said further tightening may in fact be needed.

My surveys well captured the hit of these many factors to people's willingness to spend. In February a net 18% of consumers said they planned cutting back their spending. Come June that was 42%. Now, a net 10% plan higher spending.

In January a net 57% of real estate agents said that more people were showing up at open homes. Come May a net 45% said they were seeing fewer people. Now, a net 28% are seeing more.

In July as the weight of evidence that the economy was being newly crushed was finally recognised by the Reserve Bank, signals were sent that interest rates would be cut. The official cash rate has been lowered 1.25% with cuts coming a year in advance of the mid-2025 timing outlined by the Reserve Bank in May.

My surveys referenced above have recorded some sharp improvements in sentiment and now in the population there is a strong feeling that 2025 will be all go. But in August I began some rather strident warning that 2025 would not bring the boom people seemed to be expecting simply because the foot was coming of the interest rates brake.

More recently others have begun singing the same tune – most notably Treasury and the Reserve Bank. 2025 is set to be a better year for the economy, but factors which will dampen the strength of the positives are manifold.

Upturn drivers

Some of those positives include strong international dairy prices with some signs of red meat improvement also. Infrastructure spending can go in only one direction, consumer spending is set to become stronger along with business investment, and standalone house construction prospects are improving.

But the list of offsets is long and includes the following.

Sluggish growth in our biggest export destination of China – the economy most vulnerable to an aggressive trade stance from the incoming US President.

Fresh deterioration in the NZ government's fiscal accounts necessitating a search for more revenue and additional cutbacks in spending.

Rising electricity prices and concerns about electricity availability limiting business investment plans.

Declines in multi-unit dwelling construction through 2025 into 2026.

A stalling of the growth in tourist inflows.

Rising household costs including for council rates and electricity noted above.

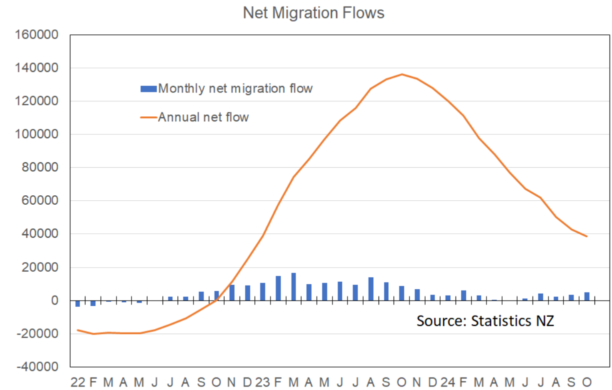
Continuing weeding out of businesses across all sectors as long-overdue decisions about sustainable size, market and product focus etc. are made.

The combination of factors suggests the economic recovery over 2025 will be muted. 2026 should be better but this far out with so many uncertain international elements in particular in play we cannot have much certainty about how much better the year might be. I discuss the housing market further below in this week's TV.

Migration easing

Statistics NZ this week reported that the country's annual net migration gain slipped to 38,800 in October from 42,700 in September and a record 136,000 a year ago. The large change in the past year reflects gross inflows falling by 65,000 while outflows have risen 32,000.

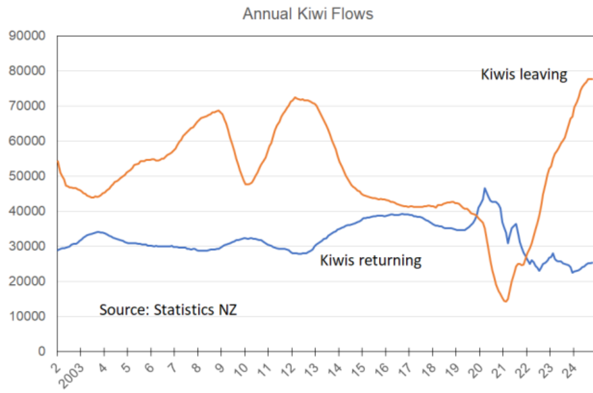
A key point to note is that the monthly numbers have settled down near 4,000 and this implies we may be at about the low point for the annual flow now or in the next couple of months. This means there is less stimulus to the housing market than a year ago, but some support is still there. An annual flow of 40,000 is above the average annual gain for the past two decades of 30,000.



A year ago the record net migration inflow was not however having a noticeable impact on the house buying market. Instead the impact occurred in the rental sector where demand was high. Now, with plentiful supply of houses to rent but slower population growth landlords are finding it hard to get good tenants.

That situation is likely to continue through 2025 into 2026 until the excess supply of townhouses for sale is soaked up.

The net Kiwi annual flow has steadied at a low of 52,300 people. Given the deteriorating outlook for New Zealand's long-term economic performance the net Kiwi loss is likely to stay high. This past week Australia's unemployment rate was revealed to have fallen to 3.9% with continuing strong jobs growth. The ease with which Kiwis can find employment if they shift across the ditch looks set to remain very good and this will especially likely encourage young people to leave.



Fiscal problems

By world standards New Zealand has a low level of central government debt. That alongside the fact we speak English, have strong rule of law, stick to our contracts (sort of), democracy, and no history of debt default means we get some of the world's highest credit ratings from the major rating agencies.

But we are highly vulnerable to earthquakes plus pests and diseases which may see primary products locked out of foreign markets. Add in an aging population bringing higher per capita costs for health and superannuation, slowing growth in China which takes 27% of our exports, a retreat in global multilateralism (more trade barriers), slow and slowing productivity growth, persistent structural fiscal deficits following six years of Labour rule, and construction cost increases and we get a need for a step change in the country's fiscal management.

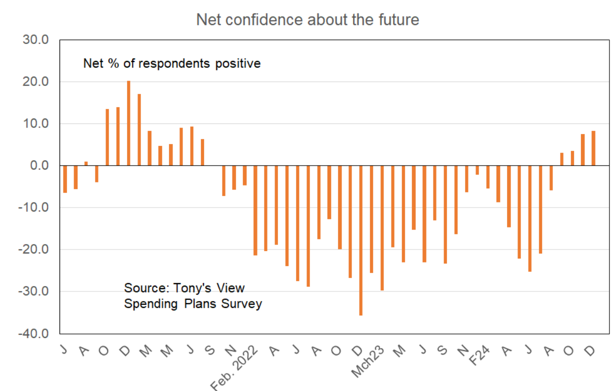
But it doesn't look like we're going to get it if we are to judge management of the issue by the Finance Minister saying of this week's Cook Strait ferry committee formation "I've delivered".

The December Economic and Fiscal Update released this week shows that the fiscal situation is deteriorating. The details have been well covered already in the media. The implications are these. Whether ACC is stripped out of the numbers or not makes no difference. High deficits imply a need for extra revenue and/or spending cuts. Covering the ACC deficit will require reduced payouts to claimants (lower spending) and/or higher ACC levies – a tax.

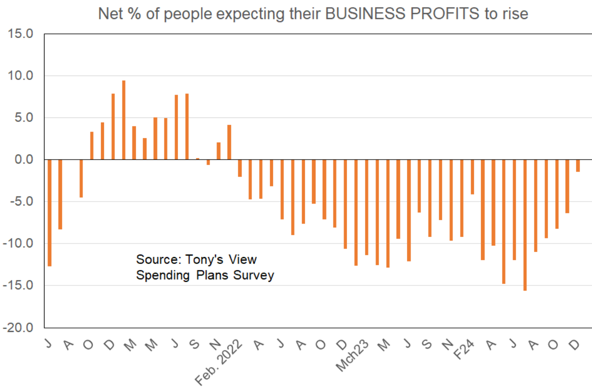
The same goes for the new OBERGALx balance definition. The prediction of no surplus until 2029 cannot be believed given downside risks to growth (lower revenue) and the persistent penchant of politician on both sides of the house to spend money. Addressing the deteriorating fiscal track will necessitate lower spending and/or higher taxes. Hence the rising incentive to take oneself and one's business out of New Zealand. You will be taxed more in coming years to pay for the inability of governments in recent times to exercise mature spending control.

Why people will spend more

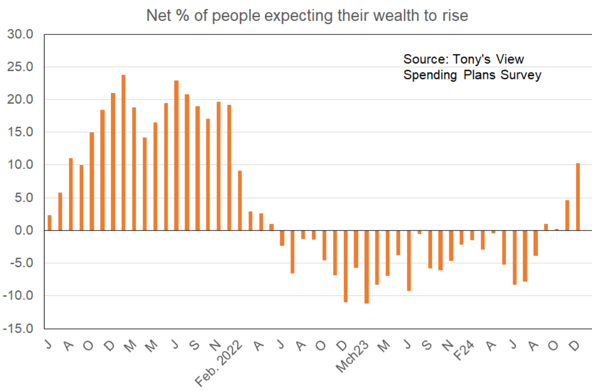
Last week I said I'd take a look in this issue of TV at the reasons people gave for deciding to spend more on stuff in the next 3-6 months. First, people are more confident about the future on average than they have been since late in 2021.



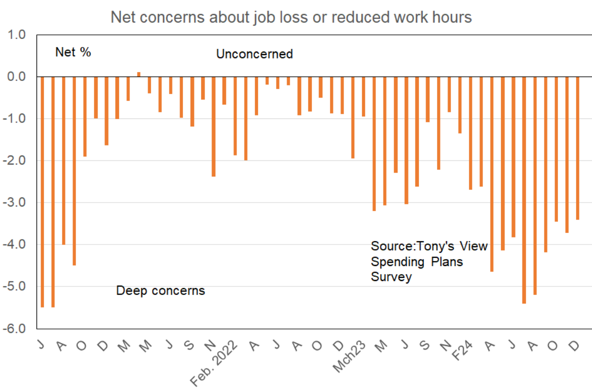
People still feel that business profits on average will fall. But the net percent feeling this way is also the lowest since late-2021.



Wealth expectations have interestingly taken quite a jump upward. I suspect this involves more than just some change in view about house prices.



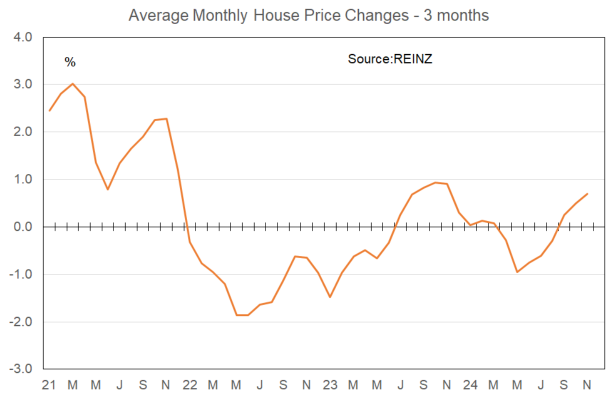
What has not changed has been worries about income. A net 3.4% of people cite wage etc. worries – little improved from a net 5.4% in July.



These things say to me that as long as people feel the economy will get better then retailers can reasonably expect some mild improvement in sales. However, should something negative come along which makes people cautious about where the economy is headed (e.g. global trade war, China slipping into recession) then the nascent retailing upturn will evaporate.

House prices are rising

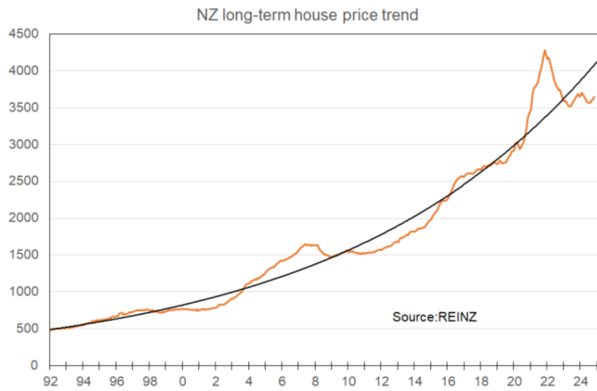
House Price Index (HPI) data released by REINZ this week show that on average house prices around the country rose by 0.6% in November after rising 0.4% in October and 1% in September. The average change for the past three months is therefore 0.7% compared with -0.3% in the three months to August, -1.0% in the three months to May and a rise of 0.1% in the three months to February this year.



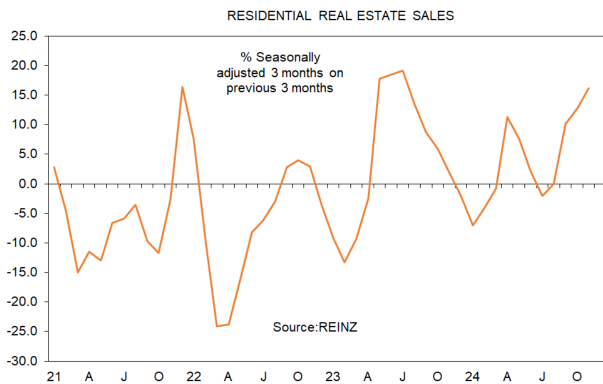
The graph here shows how things were becoming less bad last year and moved into positive price growth territory from late last year. Then the woe I have been referring to since April set in. That woe is now passing as seen in my monthly surveys and some other more lagged measures of what is happening in the economy and housing market.

But as is the case with my other housing market measures this House Price Index gauge from REINZ does not allow one to say that the residential real estate market is displaying any unusual strength. There is no frenzy in place and FOMO remains at below average levels.

This graph plots the HPI for each month since 1992 and runs a geometric trend line through for the heck of it. We can see that prices are about where they were in February 2021.



With regard to sales things are edging upward. In rough seasonally adjusted terms (shown in the next graph) sales have risen by around 16% in the past three months. The annual sales total now stands near 70,200 from a low of 58,600 in April last year.



Through 2025 I expect activity levels to move higher in a controlled manner with prices doing the same thing. The key driver will be falling interest rates. But the absence of big interest rate falls will eventually occupy people's minds. This will have the interesting effect of constraining the feeding on itself (FOMO) tendency of housing market price rises come the late part of the year.

If I were a borrower, what would I do?

I'd wait for a lift in competition between the banks to bring a 2-5 year fixed rate just above 5% and fix there. Then I'd get on with life focussing on things other than trying to be clever and pick the bottom of the rates cycle.

For a whole range of reasons you should not look for certainty about where interest rates are headed for the next four years. The key factor in play is this. Inflation rates in NZ and offshore have fallen away in response to tight monetary policies. But they seem to have bottomed out at unusually high levels and there is a growing concern afoot that much additional easing of policy could see inflation settle too far above desired mid-points.

That is, as I have been highlighting strongly here for NZ recently, the central bank feet globally have come off monetary policy brakes. But there does not appear any firm justification as yet for pressing the accelerator pedal and taking cash rates to below average (neutral) levels.

2023-25 is a story of removing monetary policy restraint. 2025-26 is unlikely to be a period of imposing monetary policy stimulus.

The second problem is this. We don't really know where those neutral rates are whereby no feet are touching the brake or accelerator pedals. Is this still a world as we experienced post-GFC when inflation globally kept surprising on the low side and we ended up deeply worried about deflation come 2019?

Probably not – but how much probably not?

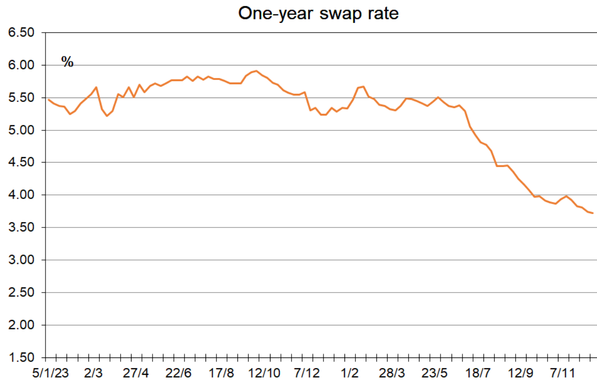
How do we factor in the deflation which is becoming entrenched in China as householders maintain spending restraint? And what impact will higher US tariffs on Chinese goods have on encouraging China to ship the resulting over-supply of goods to other countries? To dump them.

New Zealand's rate of productivity growth has fallen as the deficiencies of our business sector managers, excess public sector numbers, oligopolies, flow of skilled people offshore to be replaced by low level migrants, and lack of capital deepening manifest themselves. To what extent has the relationship between any given rate of GDP and inflation now changed? We don't know.

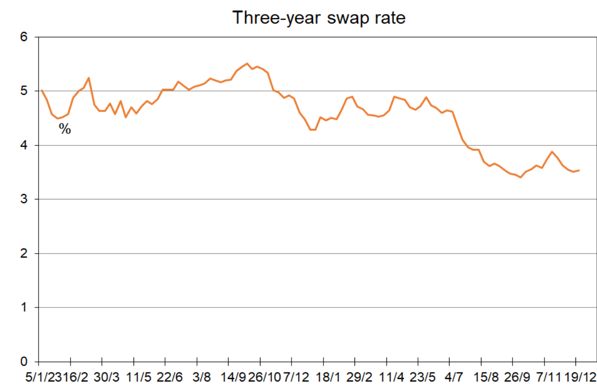
The chances of our central bank setting the official cash rate at optimal levels are low – just as they are for central banks offshore. Borrowers should recognise the high level of uncertainty we now face with regard to picking interest rate norms, trends, shocks, and shifts. How? Be prepared to pay for risk reduction by shifting away from gambling by fixing 6-18 months only as soon as the 3-5 year fixed rates seem "reasonable".

I use the word "reasonable" rather than the word "attractive" because the chances of banks deeply discounting the medium to long-term fixed rates do not seem high.

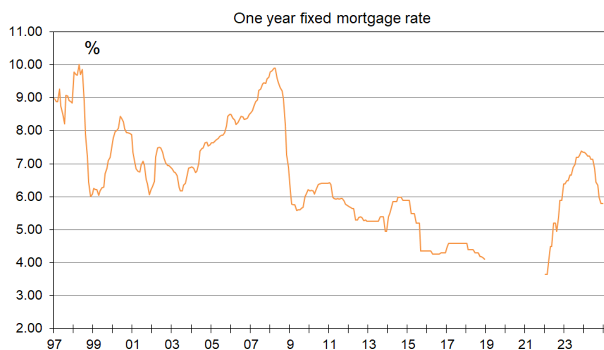
This week changes in wholesale interest rates have been minimal and not worth commenting on. The trend in the one-year swap rate remains down indicating it is reasonable to expect lower one year fixed mortgage rates and term deposit rates as we get into the first quarter of 2025.

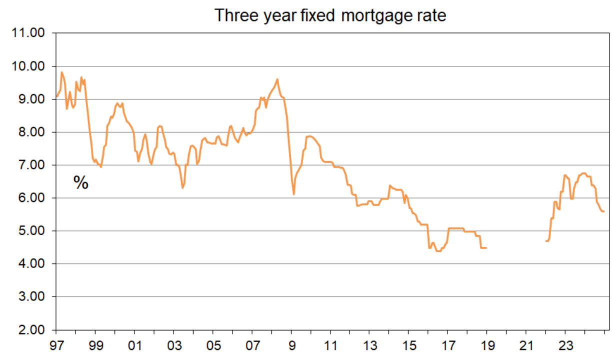


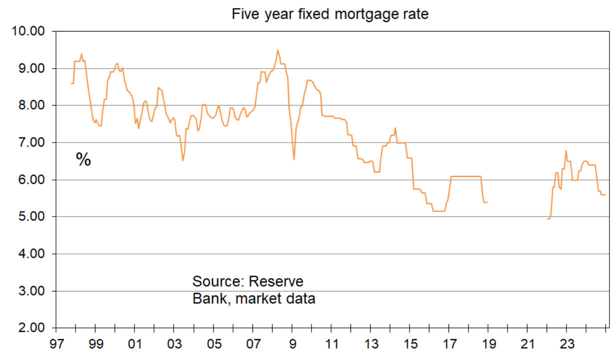
The three year swap rate trend looks less down therefore less scope exists for rate cuts. When they come next year the magnitude will be less than for the short-term rates.



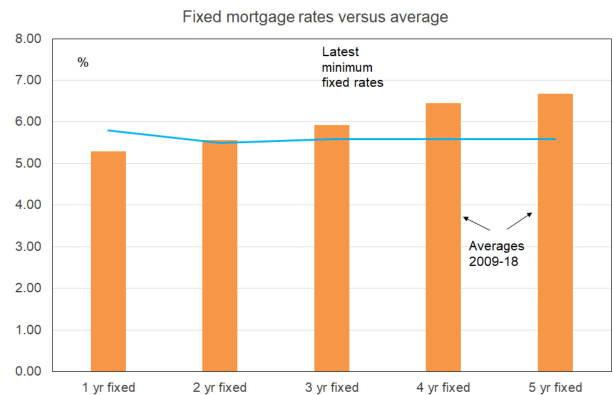
These three graphs show levels of the one, three, and five year fixed mortgage rates over the past few years excluding the 2019-21 period when rates were absurdly low because of worries about deflation and then the effects of the pandemic.







This graph shows how current rates compare with averages from 2009-19.



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