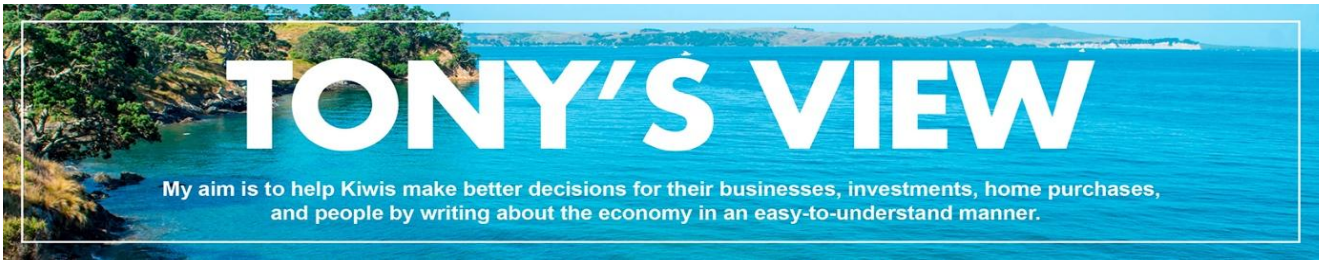

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Consumer spending on hold

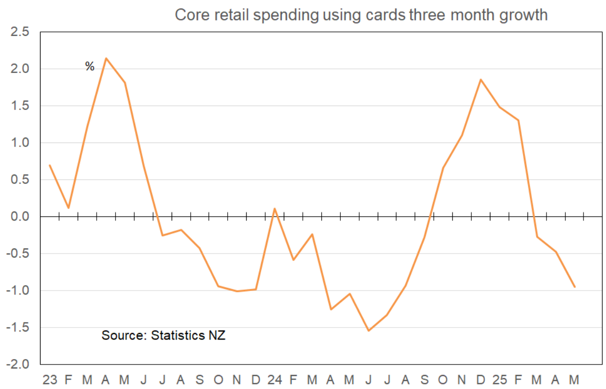
The only semi-reliable monthly indicator of consumer spending in New Zealand was released this week by Statistics NZ. The Electronic Card Transactions data show that for all spending using cards there was a fall of 0.2% in May which reversed the 0.2% rise in April.

The percentage moves mean little except to the extent that when added together we can see an absence of growth. This is best seen by averaging over at least three month periods – which is what is going to happen in a couple of years when a monthly CPI release is developed. We will nod to whatever the monthly change is but recognise the high volatility of monthly data in a small country like New Zealand and smooth over three month periods.

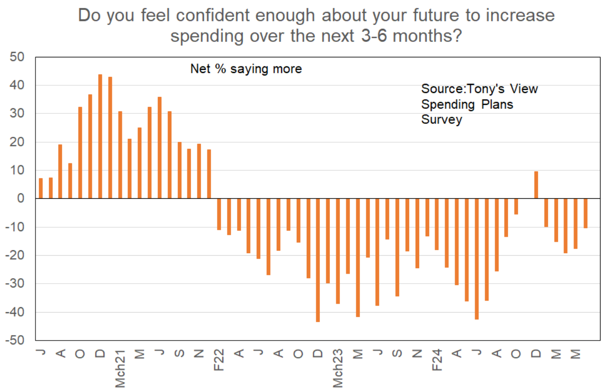
We might even get to mentioning that a month's results are biased upward or downward because of sales by major retail chains which started just at the end of a month.

Back to the spending release, we see that for the three months to May core spending which has traditionally volatile elements removed was down 0.9% seasonally adjusted from the three months to February. This is consistent with the negative comments I have been making about household spending when releasing the poor spending plans readings from my monthly Spending Plans Survey.

Note that spending on durable goods like whiteware and furniture has fallen 4% in the past four months.



People are firmly saying that they intend keeping their wallets closed and even though the latest month saw an improvement from a net 18% negative to 10% this is still a negative result.



Note how the spending change graph above shows the effect of happiness following interest rate cuts from August. Then the many factors I warned strongly about as causing restraint from that time came into play and we have what we've got today – a still struggling retail sector.

Does this weakness justify calls for the Reserve Bank to cut the official cash rate to 2.5%? I do not feel so. The Reserve Bank does not have a goal of maximising growth let alone pushing maximum growth in household spending. Their goal as specified in the Monetary Policy Committee Remit (used to be via the Policy Targets Agreement) centres on keeping inflation between 1% and 3% and close to 2% if possible on average whilst " supporting maximum sustainable employment."

Inflation is currently 2.5% which is up from the low of 2.2% in the December quarter. As stressed here for some time business pricing plans are well above levels consistent with inflation averaging 2.3% since 1992 - let alone 2.0%. Some inflation expectations measures have risen recently, and it is not clear that the combined effects of President Trump's tariff war and war in the Middle East will be lower imported inflation into New Zealand.

However, there has recently been some surprising weakness showing up in some of the monthly measures produced in New Zealand such as the Performance of Manufacturing Index from BNZ and Business NZ which has just retreated to 47.5 from 53.3. Below 50 means contraction.

Does one panic? No. I give very little credence to the medium-term trends hinted at by all monthly gauges around the world at the moment because of the disturbance occurring from the US President's actions.

There is a risk that the weak readings do not reflect the true situation and if one's central bank acts quickly to cut interest rates then excess stimulus could be applied to one's economy.

This is what our Reserve Bank did over 2020-22. They eased too much for too long by embracing a negative scenario and not having the intellectual wherewithal to recognise the world was not what they assumed. Surely the lesson of that failure has been learned and more caution regarding policy changes will now be exercised. The recent "lying" about why the previous Governor left calls that assumption of increased professionalism and ability now into doubt. Perhaps when the monitor has finished with the Wellington City Council he could be shifted to doing the same with the Reserve Bank.

What do these niggling comments mean? Predicting what our central bank will do has become a lot more difficult and potential for surprises has been enhanced.

What about maintaining maximum sustainable employment? With the unemployment rate at 5.1% one might think the case is made to cut the

OCR a lot more. Not so. The employment goal went out the window late in 2022 when the cash rate was raised 0.75% and the RB warned of the need for a recession.

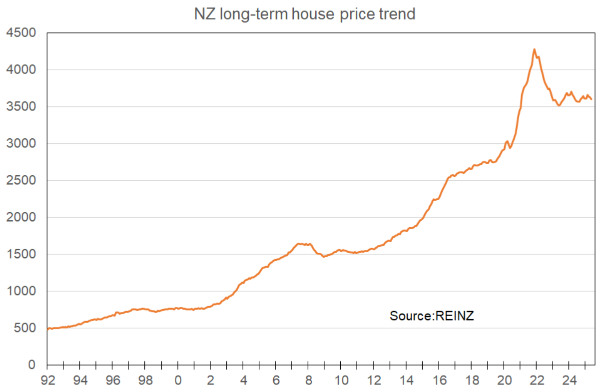
The labour market goal is subsidiary to the prime target which is low inflation near 2%.

The ANZ's Business Outlook Survey does not show fresh employment deterioration is underway. A net 6% of businesses plan hiring more staff in the next 12 months. This equals the three decade average.

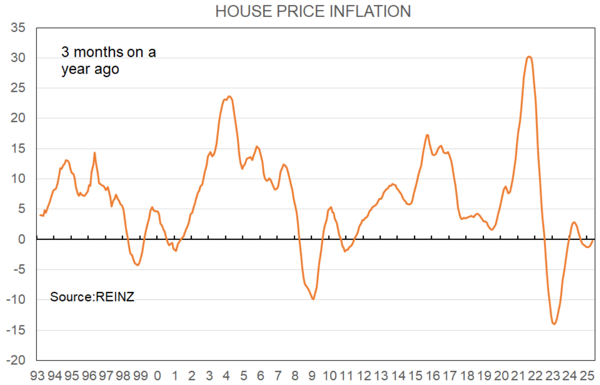
Come the next official cash rate review on July 9 there is a good chance no rate change from 3.25% will occur. This is especially so when we consider one member of the MPC voted against a rate cut last time and no discussion of a 0.5% reduction was undertaken.

House prices falling

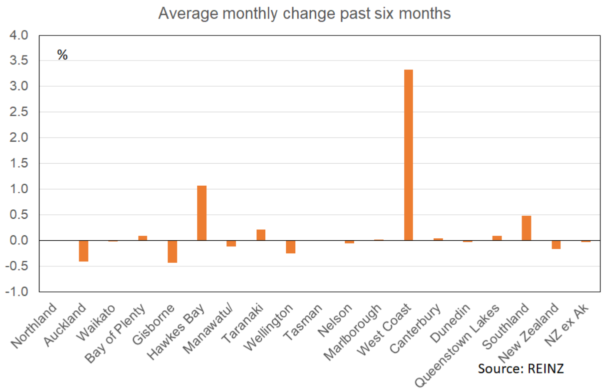
This week REINZ reported that average house prices around the country in May as measured by their House Price Index declined 0.6% after falling 0.3% in April and 0.6% in March. Prices sit almost exactly where they were a year ago and at the start of 2021. That is, there has been no price growth now for over four years.

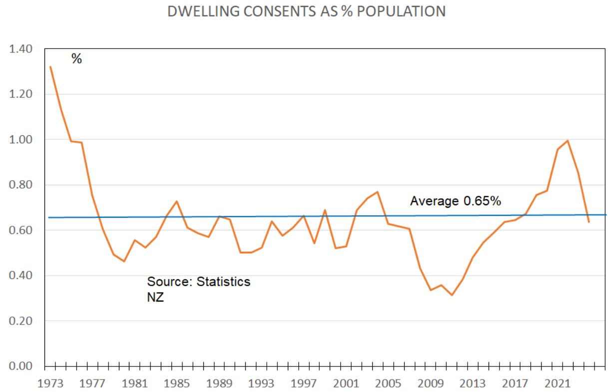


This graph below smooths things a bit by showing annual changes in three month averages. Note the pandemic surge, the post-pandemic decline amidst a credit crunch, then the lack of a sustained upturn once the period of strong decline ended around the turn of 2023 into 2024.



This next graph looks at the change in the six months to May versus the six months to November last year for each region. Note the rises in Hawke's Bay, Taranaki, Bay of Plenty, Canterbury, Queenstown Lakes, and Southland. Then note the declines for Auckland and Wellington.





Why are prices not rising despite 2% or so falls in mortgage interest rates?

1. A fall in net migration flows to only 21,000 from 135,000 net in the year to October 2023.
2. Developers trying to sell excess stock – townhouses largely. This has contributed to listings being the highest in a decade.
3. Buyers having high awareness of the property over-supply at current prices on the market and the bargaining power which they have.
4. Selling by older investors looking to realise the value of their long-held asset to fund a retirement made more expensive than expected by big rises in some key living costs such as food, rates, and insurance.
5. Low job security.
6. Awareness of efforts being made by the government to boost house supply.
7. A reduction in pressure on tenants to try and purchase caused by weak to falling rents amidst an over-supply of rental property at current prices.

For your guide, here is the graph I produced earlier this year showing the number of consents issued for new dwellings to be built as a percentage of NZ's population. The data are annual and start in 1973. The long-run average percentage is 0.65%. The latest is about 0.63%.

The key point to note is that this graph may be telling us that there has been a structural lift in the volume of house construction in New Zealand relative to population. Why? Because the ratio is only just below average despite the period of high interest rates, a credit crunch, and many building failures.

Or the graph is telling us that the ongoing relatively high number of dwelling consents being issued is a castle built in the air which may soon collapse.

I opt for the former scenario but do think many builders will still go under based on feedback from many in the sector contained in the monthly Business Survey I run with sponsorship from MintHC. That survey which I released yesterday shows these sorts of comments from businesses in the residential building sector.

- Building Supplies Trade Merchant - Continued low demand in urban areas with rural areas being more positive.
- Land Development & Land Surveying - Uncertainty in the Auckland land development market: cost to subdivide &

build are more than a realistic market value sale price.
- I feel there are green shoots of activity. Definitely more enquiry starting to happen and while clients are slow to commit it is heading in the right direction.
- It is very quiet. Enquiry levels fluctuate up and down but there is no urgency or appetite for clients to commit to projects.

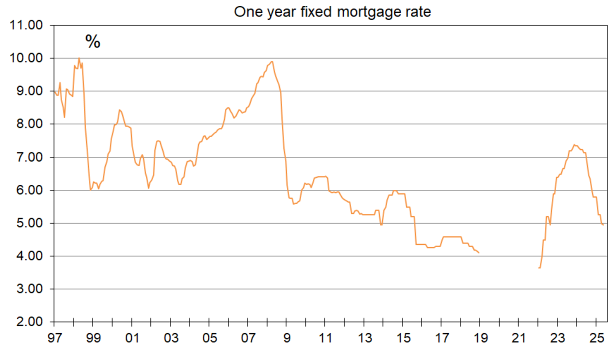
If I were a borrower, what would I do?

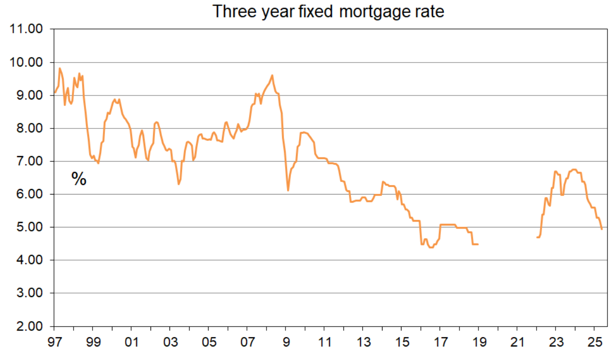
Courtesy mainly of some recent weaker than expected monthly data in NZ and the US we initially saw some small downward movements in our wholesale interest rates this week. But the declines were then reversed by higher than expected food price inflation leading to upward revisions to inflation forecasts and a pullback in expectations of a cut in the official cash rate come July 9.

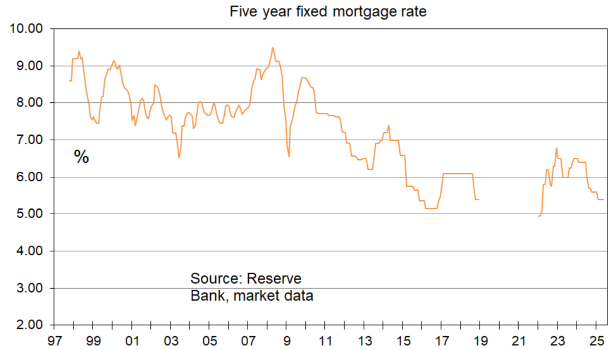
At the end of it all rates are not much different from where they were a week ago and no particular fresh pressure exists on banks to change their fixed lending rates one way or the other. The GDP data had no meaningful impact as the better than expected 0.8% result for the quarter was offset by a downward revision to the December quarter growth rate from 0.7% to 0.5%.

Given my belief that despite economic growth being likely to surprise on the downside for the rest of this year in NZ inflationary pressures will surprise the other way, I would still favour fixing at 4.95% for three years if I were borrowing at the moment.

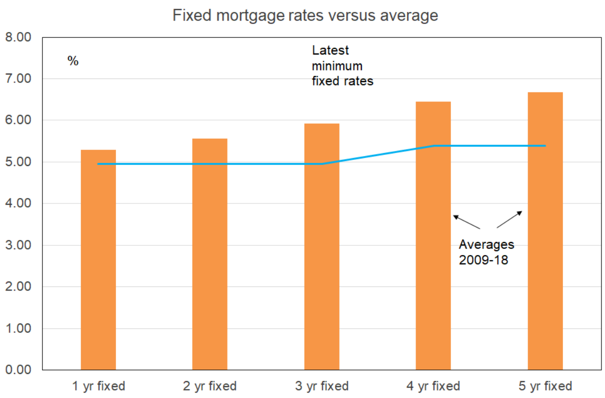
These three graphs show mortgage rates since 1997 excluding the period of deflation worries (2019) and the pandemic.







This graph shows how current rates compare with averages from 2009-18.



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.