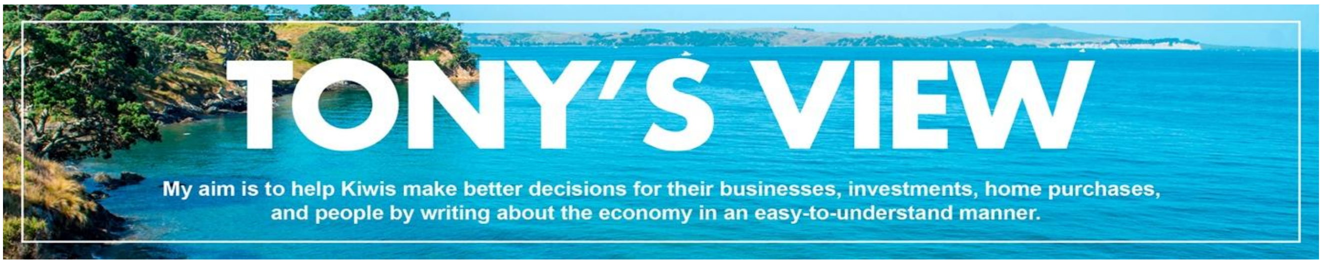

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ISSN: 2703-2825 22 May 2025
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Productivity going backwards

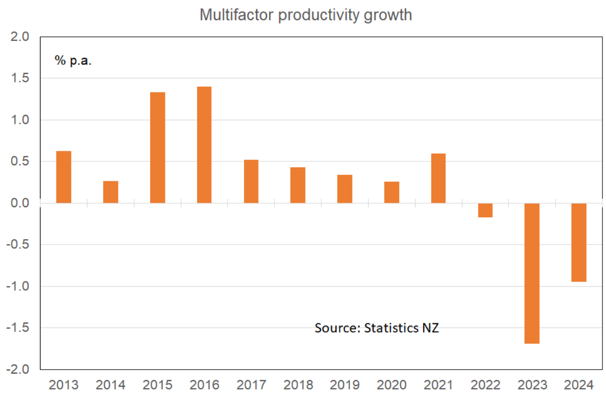
I'm sending this week's Tony's View a day early because tomorrow everyone's attention will be on the Budget. I've nothing to say about the Budget here beyond some comments in the interest rates section. Only if there is something truly significant will I write any special article tomorrow, but I won't do that just to list the same details of the fiscal numbers and policy changes as everyone else.

While the annual Budget is of huge importance to many people, I find the exercise unsavoury. People have learnt to put their hands out asking to be given other people's money and usually the media interview people asking them what they want from Santa – I mean the Finance Minister.

The outcome of many years of governments of all persuasions gifting people someone else's money only to have theirs taken later down the track to gift to others has been an increase in the role of the government in the economy. This increasing government claim on resources is not the same as the 84% debt blowout under Labour from 2017-23. We can attribute that substantially to their taking advantage of the pandemic and it seems reasonable to expect measures will be taken under National and probably again in the early years of the next Labour government to restore fiscal rectitude. But the rising role of government in the economy helps explain New Zealand's poor productivity growth record. Most recently seen in numbers discussed here. To whit…

Productivity getting worse

There was some bad news on the inflation and interest rates outlook contained in data released by Statistics NZ this week. They estimate that New Zealand's productivity fell by 0.9% in the year to March 2024 after falling 1.7% the year before and 0.2% the year before that.



If productivity is rising, then it may take a firm pace of economic growth before inflationary pressures appear. But if productivity is falling then inflation can appear very early in a growth cycle – such as our economy is embarking on now.

The general upshot of the recent run of poor numbers is that if the Reserve Bank sees growth ahead, they will feel inclined to restrain it and raise interest rates earlier in the cycle than would otherwise be the case.

It is not possible to directly translate this situation into a feeling at the moment for how much further the cash rate falls or when it starts going back up again. But in general the poor data say interest rates will be higher than would otherwise be the case.

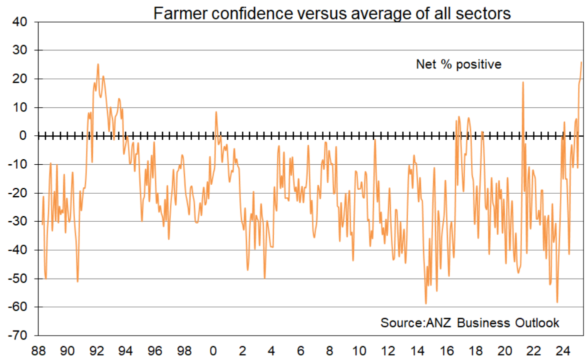
Note that falling productivity does not imply higher unemployment. If productivity is getting worse more people will be needed to produce the same quantity of widgets. But the jobs will possibly be low paying ones in order to compete with productivity growth in such production achieved by other economies.

Farmers unusually happy

The ANZ's monthly Business Outlook survey produces a number showing the net proportion of surveyed businesses expecting the economy to get better in the coming 12 months. They derive this by aggregating responses classified by the sector the business is in – retail, manufacturing, agriculture, construction, and services.

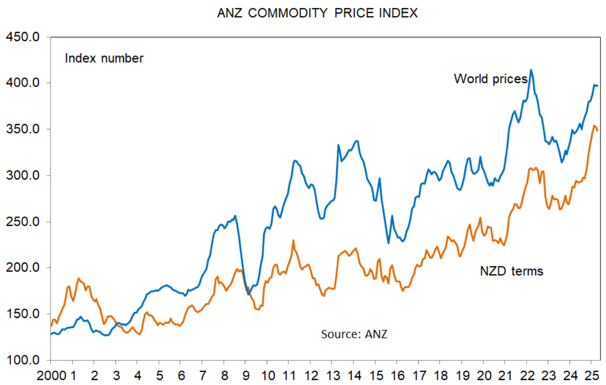
The number for their most recent survey is a net 49% of businesses expecting a better economy a year from now. For farmers the net proportion is 75%. It is unusual for the reading for farmers to exceed the all-industry average.

This graph shows the difference between farmer and all-industry sentiment. We can see that the current gap of 26 points is a record. Never before have farmers been this happy compared with other sectors.

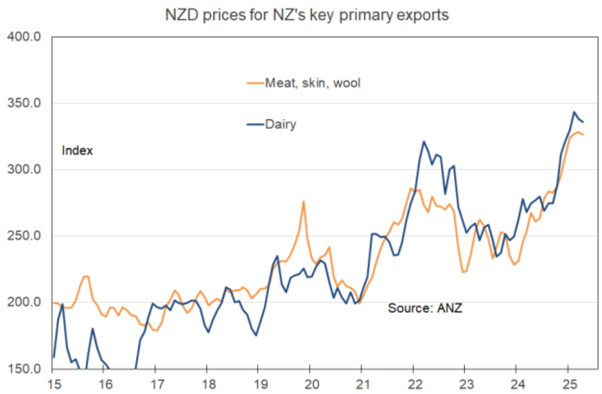


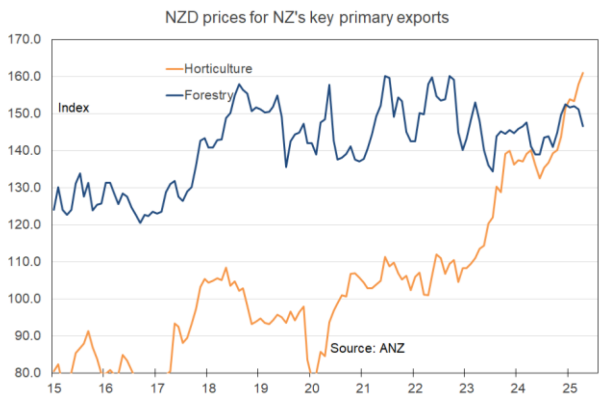
Why is this happening when we don't have their incomes being assisted by a shock decline in the exchange rate, and their costs have risen tremendously in recent years?

Probably it is the surprisingly good prices being received in world markets. In NZD terms the ANZ Commodity Price Index is running about 19% ahead of a year ago at the level shown by the orange line in the following graph.



This graph shows prices up strongly for dairy (blue line) and meat/wool products (orange line). The one after does the same for forestry (blue) and horticultural products (orange).





Prices are strong for all things on average bar forest products. That latter absence of strength reflects weakness in China's construction sector.

The strength generally reflects some low output volumes offshore, especially for beef and dairy.

It is because of these positive revenue streams in the primary sector that some people are talking about an export-led recovery in our overall economy. However, this does not mean that local towns servicing producers are about to boom. Costs of farming have soared recently and in some sectors such as dairying there is a continuing focus on paying down debt.

This perhaps explains why the level of debt in the farming sector at the end of March was down 1.3% from a year ago as opposed to growth of 3.9% for housing and 2.6% for urban businesses.

Will the high commodity prices continue? The fact that dairy prices have generally risen at the Global Trade Auctions recently despite worries about world growth because of President Trump's tariff war suggests some scope for hope that these good prices will be sustained through 2025.

Business dour

With regard to how businesses are feeling at the moment, I released the results of my monthly survey sponsored by MintHC yesterday morning. As I noted at the start of the section containing comments submitted by respondents, if there were no numbers produced anywhere on the state of our economy, I would conclude from the comments that we are probably still in recession.

Businesses are finding 2025 to be surprisingly weak. They survived 2024 and expected better. Costs continue to rise, margins are compressed, customers are not coming through the doors as hoped, and there is disappointment in the political environment.

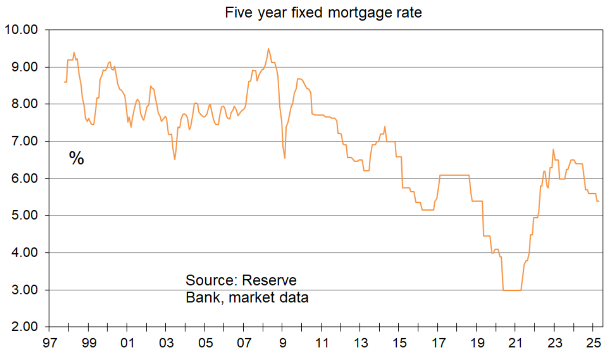
I warned strongly in the second half of August last year that 2025 would not be the boom people seemed to think it would become back then simply because the restraint of tight monetary policy was being removed.

The environment we are in is one in which more weeding out of businesses is going to occur across all sectors for all the year. Watch your cash flows very closely and be careful of your assumptions about two things. First, the ability of your debtors to survive and pay you. Second, the willingness of your bank to finance you through another period of weak cash flow.

We re not back in recession. There is a recovery underway. But the recovery is weak and set to stay that way until next year sometime when better conditions are expected – unless the world economy falls over because the United States President decides to strike again.

If I were a borrower, what would I do?

Next week will be exactly five years since the first major bank started to offer a five year fixed mortgage rate at 2.99%. The rate was available through to the final week of April 2021 which means this. Over the coming year there will be some people who roll off their old fixed mortgage rate not into something lower to reflect the easing of monetary policy since August last year, but to a higher rate.

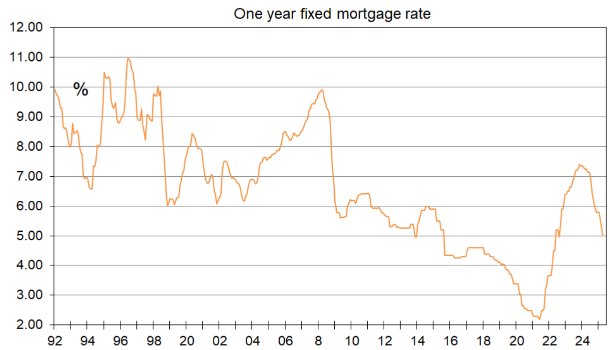


They will go from 2.99% to something close to 4.99%. Chances are this will not be a burden for these people as I assume they have taken advantage of the past five years of a low rate to get their debt level down quite well.

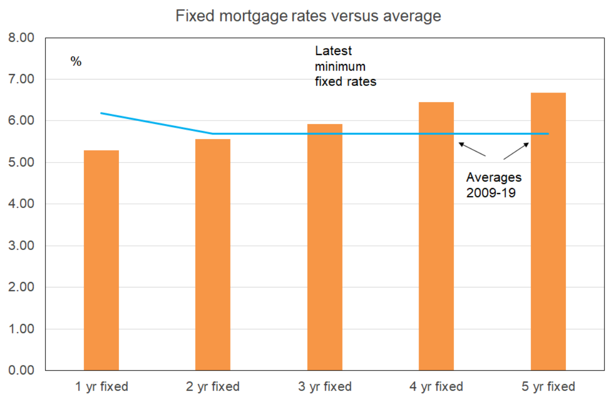
The problem of course is that there are not enough people rolling onto a mortgage rate 2% higher than they were paying. That is because the vast majority of people 4-5 years ago did not fix five years and instead took the cash flow sugar hit of fixing one year at the 2.65% - 2.99% one year fixed rate which prevailed for that one year period.

When the 2.99% five year rate was available the unemployment rate ranged from the 4% we entered the pandemic with to a quick peak of 5.3% then down to 4.0% again. So, for some people the need for low cash outflows would have been there, including for those running businesses. But for most people it was simply a matter of going for the lowest rate possible.

They then paid the price when the Reserve Bank tightened monetary policy from October 2021 (slowly at first then strongly from November 2022) and the one year fixed rate when from the 2.29% low to 3.65% at the end of 2021, 6.39% at the end of 2022, then a peak of 7.35% at the end of 2023.



The rate is now commonly 4.99%. Does this mean one should avoid fixing one year? No. Since the GFC this has been the cheapest thing to do on average. This can be seen in the graph I include in this section each week showing orange columns representing the average cost of fixing 1-5 years in the period from 2009-19.



I stopped the calculations at the end of 2019 because then we entered the pandemic period during which interest rates were at low levels too long and started unusually low because of the unique worries about deflation over 2019. Those deflation worries caused the Reserve Bank to cut the cash rate to a record low of 1.0% - lower than the 2.5% during the GFC.

But just because something has worked well on average does not mean the extremely rare appearance of a gift horse should be ignored.

Is there any such gift horse opportunity available to borrowers at the moment? Not in my opinion. You can fix one year at 4.99%, three years at 5.19%. Meh. Nothing jumps out as being worthy of me jumping up and down as I did for that 11 month period over 2020-21.

If I were borrowing at the moment, I'd look for a three-plus year rate of 4.99%. I still think there is a chance of such returning, but it may take a shift in where banks are competing for mortgage business.

There is little outright rate discounting going on and instead their focus is on cash backs, some easing of lending rules, and the likes of one bank's 10-year interest-only facility for investors.

Maybe the shift to rate discounting won't occur until banks have boosted their backroom processing staff numbers which mortgage brokers indicate are woefully inadequate.

Turning now to see if anything meaningful has happened with wholesale borrowing costs this week just ahead of the 2.00pm reading of the Budget. Our fixed borrowing costs can be heavily influenced by shifts in US fixed rates and many divergent forces are acting on US bond yields at the moment.

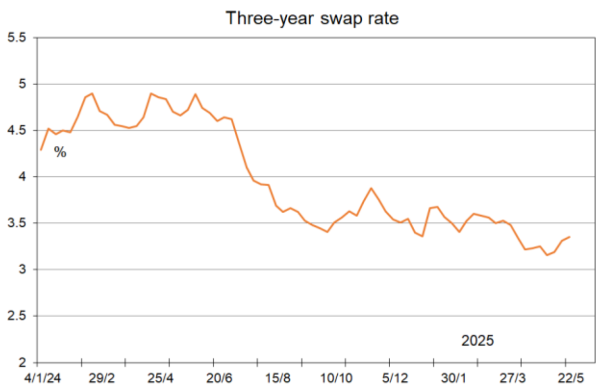
There was upward pressure for instance this week from Moodys Credit Rating Services downgrading US Treasury long-term debt to AA1 from Aaa. There was downward pressure from a measure of consumer confidence falling to its second lowest level on record. And there was upward pressure from their year ahead consumer inflation expectation rising to 7.3%.

Out of Japan we saw some upward pressure because of low demand at a government bond auction. But out of Australia we got downward pressure following the 0.25% cash rate cut to 3.85% on Tuesday and the Reserve Bank of Australia noting they gave thought to a 0.5% reduction. That comment had not been expected, so markets have increased their expectations for cash rate cuts from the RBA.

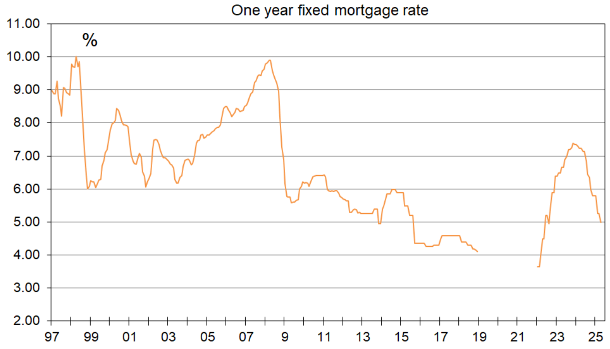
Finally, with a wave of selling overnight in the US on a general "sell America" feeling that the country is losing its safe haven status, yields there have finished up for the week. This means the NZ one year swap rate at which banks borrow to lend to you and I at a fixed rate for one year has started this morning near 3.15% from 3.12% last week and 3.11% four weeks ago.

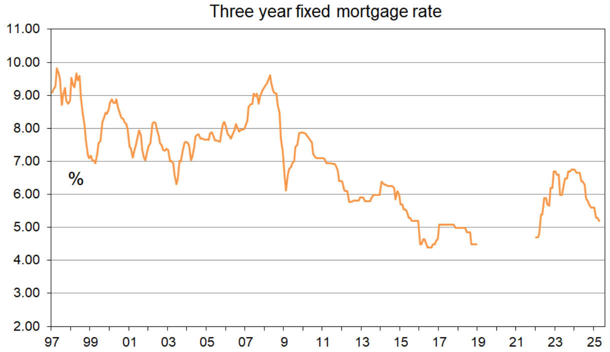
The three year swap rate has started this morning near 3.35% from 3.31% last week and 3.25% four weeks back.

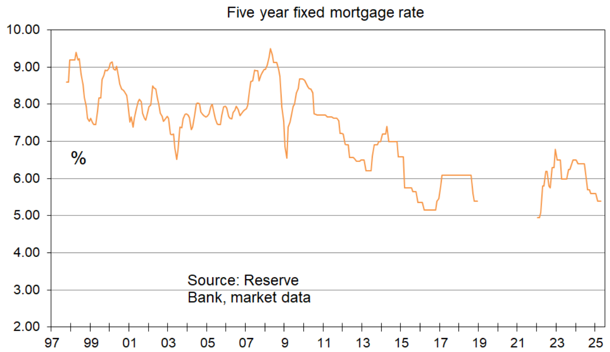
I retain my warning that wholesale interest rates apart from the shortest of terms have probably already seen their lows for this cycle.



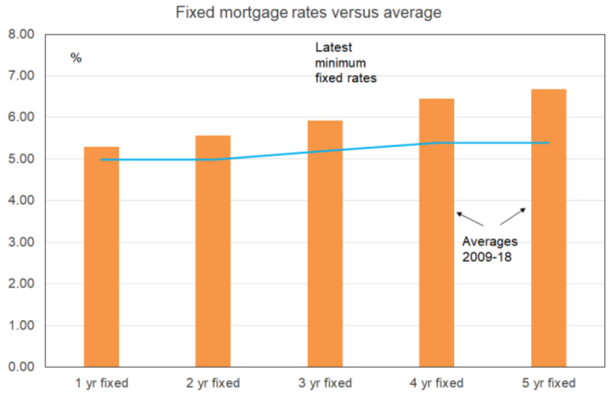
These three graphs show mortgage rates since 1997 excluding the period of deflation worries (2019) and the pandemic.







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



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.