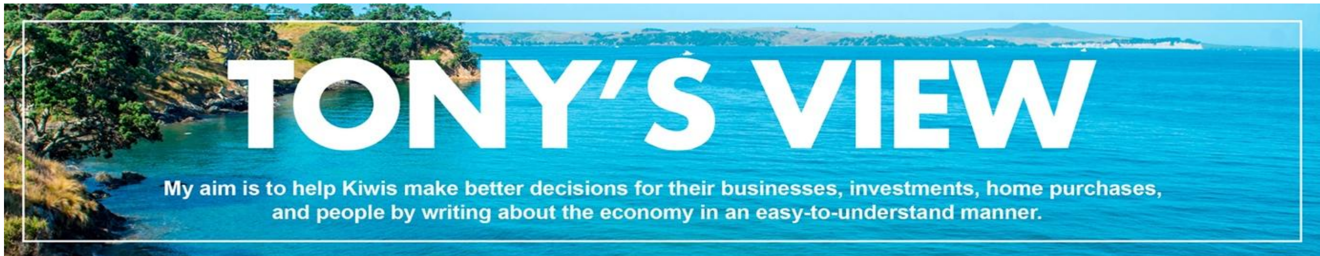

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Inflation not yet down and out

Yesterday's data showing the annual inflation rate steady at 2.2% in the December quarter last year was fairly much as expected and elicited only a minor reaction in the financial markets.

With this release the trick is to look beyond the headline number and see what measures of underlying inflation are doing. This needs to be done because it is easy to get special factors which boost or lower the result over one or two quarters and inflation may actually be running at stronger or weaker rates than one thinks. That is important for setting monetary policy and minimising times when sudden changes in interest rates have to be made because reality turns and to be different from what a central bank is thinking.

In truth the history of monetary policy in many countries is one of having to quickly raise or lower rates because things were not tracking as thought. But it is worth a go nevertheless so let's have a look.

If we do what the Americans like to do and strip out food and energy price changes which can be highly volatile, then inflation for the December quarter was 0.9% and not the headline 0.5% and the annual rate 3% rather than 2.2%. That is not so good.

A popular focus in New Zealand is on the non-tradeables rate of inflation which is calculated by removing the 40% or so of the 649 items in the CPI basket which are imported or have their prices heavily influenced by developments offshore and the exchange rate.

Doing that we see that while tradeables inflation for the quarter was 0.25%, non-tradeables was 0.66%. The latter is the lowest since mid-2020 and a good development following the 1.2% rise in the September quarter. But the annual rate of non-tradeables inflation is still 4.5% which is 5.6% more than the tradeables rate of -1.1%.

This tells us that the main reason our headline inflation rate is 2.2% is because of developments having nothing to do with the Reserve Bank and our economy by and large.

The 4.5% non-tradeables inflation rate is above its 3.5% average while the -1.1% tradeables rate is

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below its 1.4% average. This latter situation does not look sustainable.

Therefore, analysis of inflation broken down into tradeables and non-tradeables tells us that the situation in NZ is not good.

Another method of trying to look through the headline number is by simply stripping out the top 10% of things going up in price and the top 10% going down. This is called trimmed inflation, and the rate was 0.5% in the quarter and 2.3% for the year. That is uninteresting.

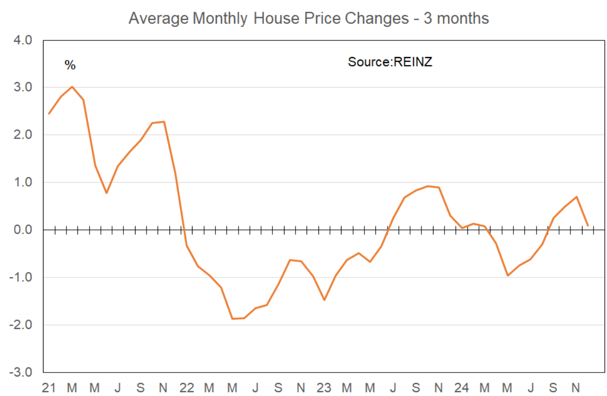
All up, the direction of travel for inflation in NZ is good but not good enough to warrant any acceleration in the pace of monetary policy easing. The potential for just a 0.25% rate cut come February 19 remains though odds for the moment still favour 0.5%.

House price cycle subdued

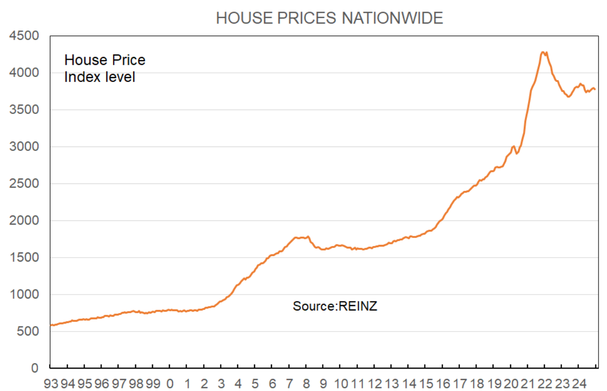
REINZ released their monthly data on New Zealand's housing market this week and the numbers show that on average house prices are going nowhere. For the month their House Price Index nationwide fell by 0.8% but it is best to smooth things over a few months to get a feel for what is happening.

Doing this we see that the average monthly change for the three months of the December quarter was a rise of 0.1% which followed average gains of 0.3% a month in the September quarter and falls averaging 0.8% a month in the June quarter.

This graph shows these changes. There is no convincing surge. Young buyers are active, but investors remain quiet. Any lift in broad interest following the change in expectations for interest rates from July last year has had only a minor price impact.



NZ average house prices largely sit where they were early in 2021. That is, no growth from four years ago but average rises since the end of 2014 of about 83%.



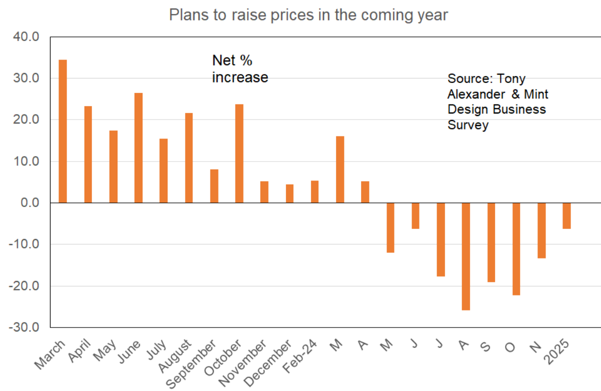
Looking ahead I expect house price growth to improve. But as noted many times from a couple of years back, gains this cycle will be muted. The costs of running a rental business are greater than before (rates, insurance etc.), interest rates are not going back to the levels they were at for much of the period from 2016-21, and growth in new house supply has structurally increased.

Businesses uncertain and hesitant

This week I sent out the results of my first Business Survey for 2025 sponsored by Mint Design. The key things which I took away from the responses of some 528 people include the following.

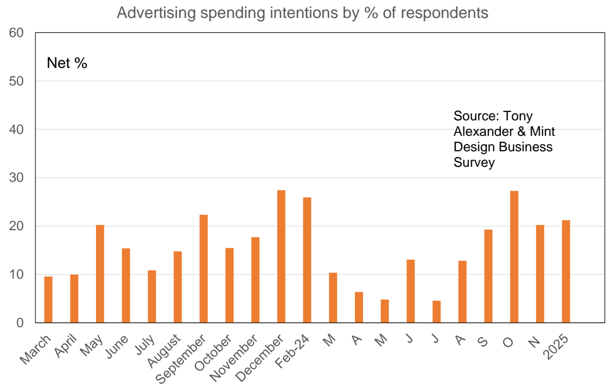
Businesses see improvement in their revenue this year but some of that confidence has pulled back recently. There is a lot of uncertainty about what exactly lies ahead, and I detect more caution kicking in.

A net 6% don't plan raising their selling prices in the coming year which sounds good and is much better than the net 5% almost a year ago planning to raise their prices. But in July a net 18% planned no rises, August 26%, September 19%, and October 22%.

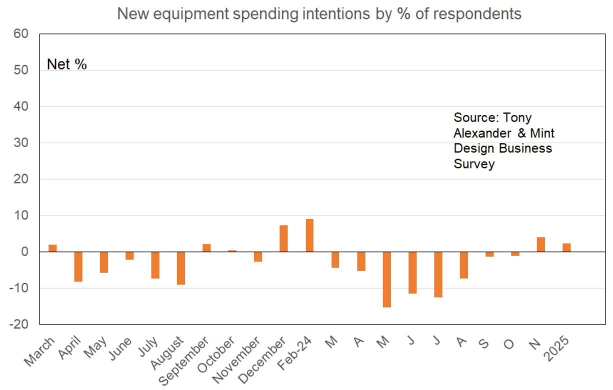


I read this as consistent with the warning I've been stressing that as economic conditions improve businesses are going to work to rebuild margins by raising their prices. It's nothing to panic about but it reinforces the chances of just a 0.25% rate cut from the Reserve Bank come February 19.

One sign that businesses are willing to back their better outlook for the economy is a rise in the net proportion planning higher spending on advertising over recent months.



But a real test is the plans which businesses have for investing in new plant and machinery. They are positive but weak at just +2% net. Tentativeness prevails and much as the export sector will receive some unexpected assistance from the recent weakening of the NZ dollar, there is no reason yet for believing that the upturn over 2025-26 will be robust.



I also have conducted my first survey of residential property investors for the year

sponsored by Crockers Property Management and results were released on Tuesday. 354 people replied in this month's survey and a key thing I take away from the responses is that the housing market upturn underway is still not much being driven by investors.

They remain highly concerned about rising costs such as for insurance, maintenance and council rates. Property buying plans net of selling intentions are still in negative territory and well removed from positive net readings over 2021-22.

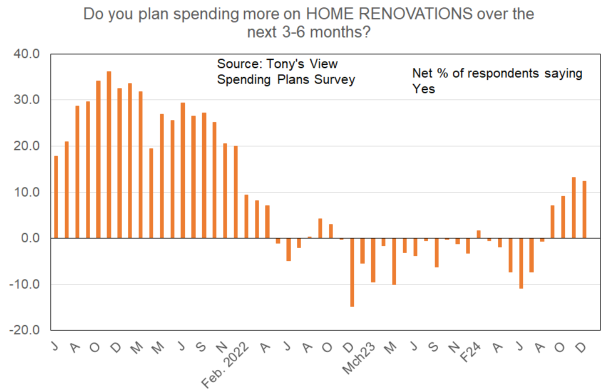
Investor interest in new-builds remains low, it is hard to find a good tenant, planned rent rises are low by standards of the past four years, but banks are seen as willing to advance finance.

Stronger home renovations

During the week there was a news article regarding an uptick in people's orders for home renovations and perhaps also houses. [‘Mitre 10 rammo with tradies’ - builders’ phones ringing hot again as reno fever takes hold, All things property, under OneRoof]

This is something we could see appearing in my monthly Spending Plans Survey in about September last year. The survey early that month showed a net 7% of consumers planning to spend more on home renovations in the coming 3-6 months. This was up from -0.6% in August and -10.9% in June and the best result since the end of 2021.

This graph shows the upturn in September and how it strengthened into the end of the year.



I will be conducting my first Spending Plans Survey for 2025 in three weeks time and it will be interesting to gauge the momentum in this sector.

The question to be answered is whether this lift in renovations activity will be followed by a lift in house construction. If so then I expect such a lift to be led by standalone housing with multi-unit developments (townhouses) lagging due to some image issues, lack of necessary presales, and bank financing caution – not to mention investor caution as they witness the Du Val developments.

The problem is that when we go to Statistics NZ to get data to compare consent issuance for new dwellings to be built and renovations, we find this unfortunate situation. “Residential alterations includes relocated dwellings, and domestic outbuildings such as garages and sheds on residential sections.”

In other words the data do not include kitchen and bathroom or any other renovations to one's house which do not require a consent.

So, all we can do is theorise that a lift in spending on renovations will be followed by a lift in house building as noted above.

If I were a borrower, what would I do?

Wholesale borrowing costs have not altered to any meaningful degrees over the past week though optimism that the February 19 cash rate review will be a cut of 0.5% rather than 0.25% has increased.

This mild rise in optimism was driven largely by one of the underlying measures of inflation released yesterday coming in slightly below Reserve Bank expectations. That is good. But it pays to remember that economic data in New Zealand can be volatile as well as perennially out of date.

So far, the cash rate has been cut from 5.5% to 4.25% over a six-month period which is not especially rapid. The Reserve Bank is not panicking about the state of the economy and the case for a 0.75% rate cut in four weeks is weak. It is a coin toss between 0.25% and 0.5%. Which means what for borrowers?

The markets have factored in a 0.5% cut. It is unlikely to be more so scope for extra downward moves in medium to long-term bank borrowing costs is minimal. That means any cuts in fixed mortgage rates for terms of two years and beyond from current levels will be minor in coming months.

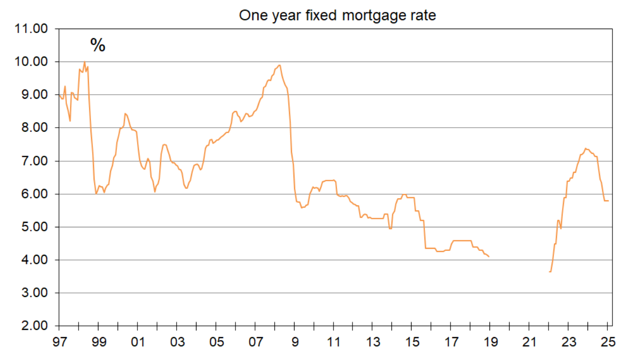
I have a belief that at some stage banks will boost competition between themselves and rate cuts will come. But the extent of declines left in this cycle for periods two years and more looks minor.

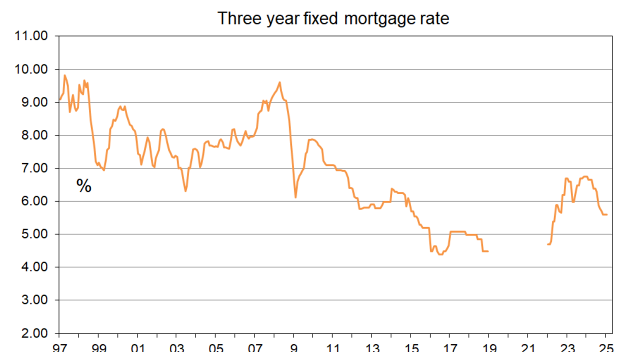
At the moment one can lock in a two year rate at 5.29% from one lender. That is better than 6.89% a year ago but well above 4.65% in early-2018 and 4.39% in early-2016. We are probably not going to see interest rates back at those levels.

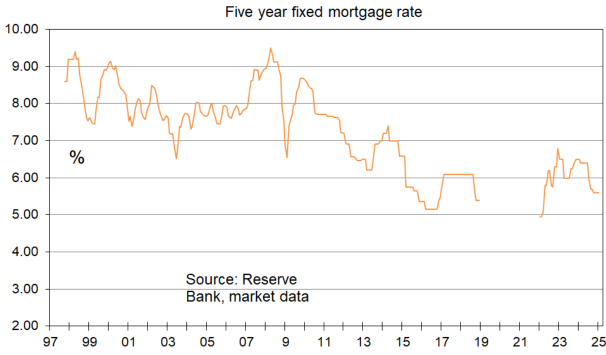
As stated previously, I'd be happy to lock in for a period of three years or more if able to secure a rate very close to 5%. But I don't think we are there yet so for the moment would stay short, maybe fixing six months for about 5.99%.

However, note the risk that February 19 brings only a 0.25% rate cut. That could see small rises in some fixed rates occur. And allow also for the new uncertainties surrounding the policies and statements from the US President. Predictability in markets has declined and that is something worth protecting against by shifting some of one's interest rate exposure to a longer term.

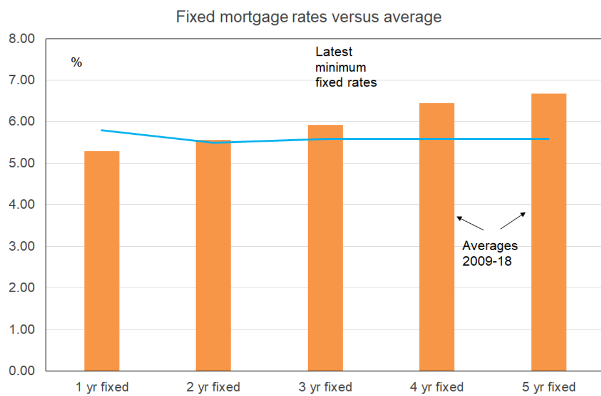
These three graphs show levels of the one, three, and five year fixed mortgage rates over the past few years excluding the 2019-21 period when rates were absurdly low because of worries about deflation and then the effects of the pandemic.







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



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