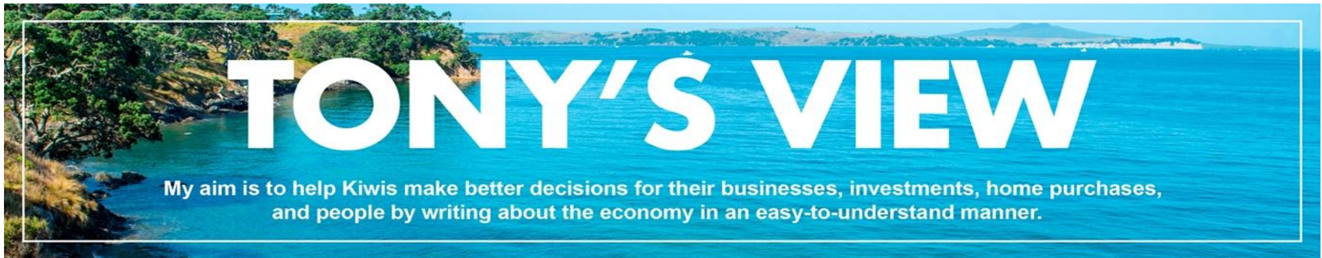

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Another event rendering forecasts dubious

Thank goodness (from a forecasting point of view) I took a decidedly negative tone towards the likely strength of our 2025 upturn from August last year. The data show our economy not firing upwards to a strong degree, sentiment surveys have turned downward, the world growth outlook has deteriorated because of the United States' tariff war ("deteriorated sharply" according to the WTO), and other economists have begun cutting forecasts for our growth rate.

Things are so disturbed and uncertain that none of us is prepared to try and find a catch-phrase as we used from early last year - namely the old "survive to '25". I dropped a couple of "you'll get your fix in '26" mentions a few months ago after my August missives, but that feels too optimistic a position to embrace at this stage.

At the start of the Covid-19 pandemic in 2020 it took us a while to realise that none of us could reasonably expect to accurately forecast what was going to happen because none of us had experience of what usually happens during a global pandemic.

Now, none of us can reasonably expect our forecasts to be right given that none of us has experience of how financial markets, consumers, business, governments, central banks, housing markets, and our economies usually behave during a global tariff war, and potential decoupling of the world's two biggest economies.

Or, in the words of the Fed. Chairman last week, "**There isn't a modern experience of how to think about this.**"

We are again in an environment of very high uncertainty which we expect to retard the willingness of consumers and businesses to spend and hire regardless of how trade flows alter. That naturally leads to this important question.

Can we reasonably expect that the reaction of governments and central banks to this growth hit and hike in risk will be to strongly ease fiscal and monetary policies? No.

Our government will not radically ease fiscal policy because they are not the same spendthrifts who were in power five years ago. There is a need

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to get the country's fiscal accounts back in order and reduce the productivity-sapping effect of excessive government size. There is also an absence of the closed borders of five years ago and the lockdowns.

The Finance Minister in fact has this week given a warning that there will continue to be a tightening focus in the May 22 Budget.

What about interest rates? There is scope to cut them, but we can expect the change in personnel at our central bank to thankfully produce better policy (and professionalism) than prevailed for the past seven years, assisted by pandemic lessons learned. We are not starting from a position of worries about deflation as was the case in 2020 when the cash rate had already been cut to just 1% because of those concerns.

Costs continue to push upward for NZ businesses, margins are squeezed, and there is an accruing and eventual margin-rebuild inflation surge buried beneath the headline figures.

People should not expect slashing of interest rates, printing of money, removal of LVRs etc.

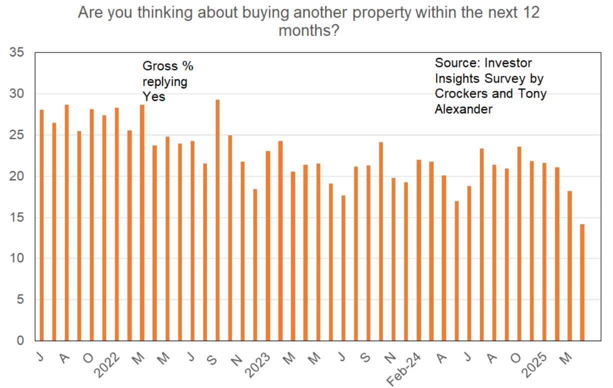
It's a mug's game trying to pick how low the official cash rate will go this cycle and it pays to remember that we have seen some errant forecasting from large groups of economists about the cash rate in recent times – last year's early-February effort by one bank's people being a prime example.

None of us, myself included, has proven ability to accurately track our economy's path through these unique shocks. Just take things as they come, don't radically alter strategic plans, but be brutal on improving productivity and rationalising outputs and customers. And don't expect a government or central bank saviour this time around. Largely, you're on your own. The buffers were almost all used up under Labour.

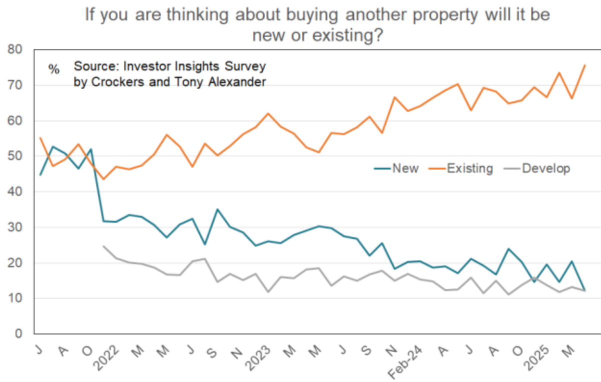
Tenants have the upper hand

Yesterday I released the results of my monthly survey of existing residential property investors undertaken with sponsorship from Crockers Property Management. There are some quite strong findings in the survey which I would like to emphasise here.

First, investor intentions of buying another property to add to their property are at their lowest level since I started this survey in the middle of 2021.



Second, for those who are thinking about buying there are record low intentions of purchasing a new-build – shown as the bluish line in the following graph.



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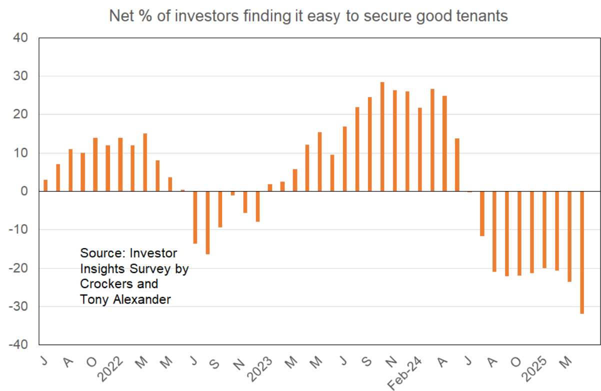
Third, there is a record level of difficulty being reported by landlords in finding a good tenant.



The rental market is awash with townhouses, net migration is weak, costs have escalated for rates, maintenance, and insurance, and long-term capital gain prospects have structurally reduced.

What does all of this mean? Mainly an absence this cycle of the bottom layer of the investor pyramid involving people with minimal capital and experience feeling they are silly if they don't buy a property like she down the road is doing. Investing in a rental property is no longer a matter of moment as it has been for the previous three or so decades.

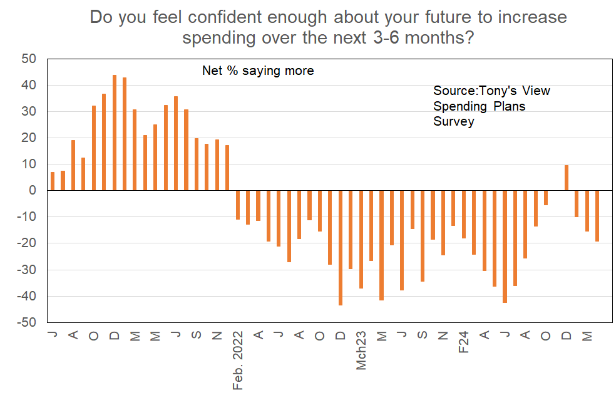
The professionals, the long-term investors, and those looking to diversify an existing asset base will remain, however.

What might be considered the main characteristic of the housing market this cycle (from early-2023) so far? Strong purchasing by first home buyers taking advantage of investors looking to sell, an over-supply of townhouses, (thus strong listings) looser bank lending conditions, and lower interest rates.

A summary

For your guide, here are some of the main graphs showing the tones coming through from my surveys this month.

Consumers are pulling back on their spending plans.



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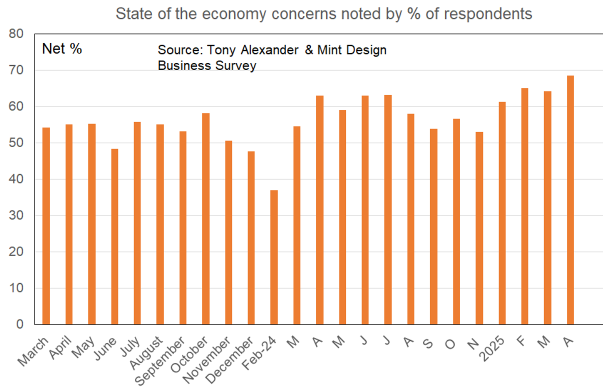
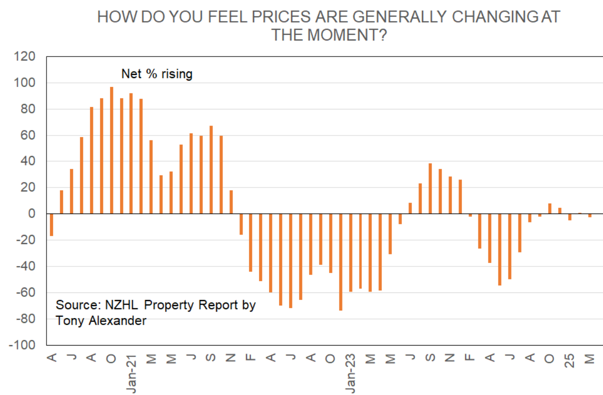
Businesses have shed confidence that the economy will truly improve this year.



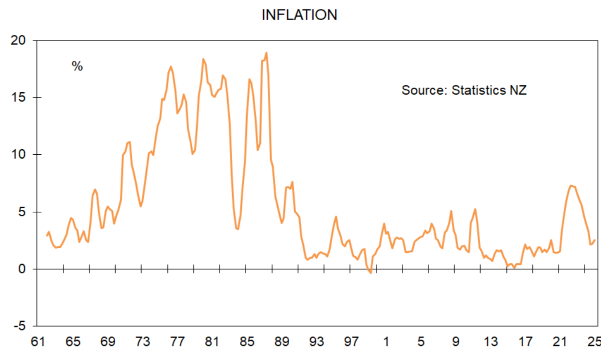
House prices are failing to gain upward traction as a rise in unhurried buyers is being met by a rise in the number of vendors and an over-supply of townhouses.



If I were a borrower, what would I do?

The quarterly release of New Zealand's inflation numbers in the form of the Consumers Price Index happened just before Easter. The outcome was broadly in line with expectations but maybe a tad higher than a few were thinking.

The annual rate of inflation has moved up to 2.5% from 2.2% so we are still in the 1-3% target band. So far, so good. During the March quarter prices on average rose by 0.9% but you shouldn't annualise that to 3.6% and conclude we have a problem as many factors can easily move quarterly data around.

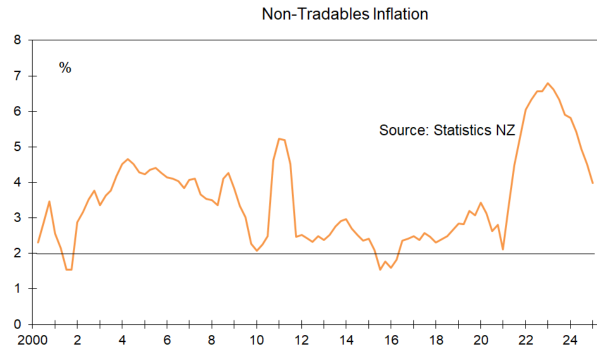


If we average with the December quarter rise of 0.5% then we are running at an annual pace of 2.8%. That provides no argument for cutting or raising interest rates. But let's dig deeper.

If we do what many American analysts do and exclude food and energy, then the quarterly rise was 0.5% following 0.9% the previous quarter so still 2.8% annualised. Nothing interesting there.

Let's now switch to the modern focus which is on the tradeable and non-tradeable component. This split exists because the biggest impact which monetary policy can have is on the Kiwi business pricing of things which are not exported or imported. These are called non-tradeables and they make up about 60% of the near 650 items in the index basket.

During the quarter the non-tradeables index rose 1.1% after rising 0.7% the previous quarter. That annualises to 3.6% for the past six months which is about equal to the average annual change for this measure since 2000. That is good. The graph here shows the actual year to March rate of non-tradeables inflation which is 4% and still above average.



One would think after the extended pain from tight monetary policy that this rate of inflation would be below average. It is not and that is where I find reason for caution regarding scope for the Reserve Bank to keep cutting interest rates.

Other measures of underlying inflation are around 2.5% so it seems safe to say inflation has fallen away and we are within the target band. My concern is how long we stay there. But for the moment that concern is having to be kicked down the road because it is right that the central bank instead give thought to the impact of the US trade war.

That war is delivering downside risks to growth. But the impact on inflation for the next couple of years is impossible to figure out. How long will tariffs remain? What level will they sit at? How scared to spend are businesses and consumers around the world? How much product will China dump outside the US?

Good luck trying to figure all of that out.

But into the mix we need to ad something which is also very worrying. The US President is looking for ways to get rid of the current Fed. Chairman Jerome Powell and replace him with someone who presumably will have a strong bias towards cutting interest rates.

The outlook for US inflation is becoming worrying and that in turn along with the political interference being attempted in the policy process carries a deep risk for pricing of US Treasury note and bonds.

Now, add in the risk that the Chinese choose to exert extra pressure on the US economy by selling some of their considerable stock of US treasuries. They hold about US$800bn or some 10% of US treasuries on issue.

On top of that, with the global government debt to GDP ratio now at 93% from 78% a decade ago and budget deficits under new pressure from slowing growth, greater bond issuance into a saturated market lies ahead. That will place upward pressure on yields.

Upside risks exist for US medium to long-term interest rates and because these rates form the bases from which other instruments are priced around the world his means upside risks for our medium to long-term interest rates as well.

Worries about inflation help explain the surge in gold prices and if I were managing a large portfolio of assets, I would be very wary of focussing strongly on short-term negative economic growth risks. Why? Because doing so will immediately bring a Pavlovian expectation of central bank easing to reduce the economic weakness. They used to call this the "Greenspan put" back in the 1990s.

Expectations of central bank easing from "an abundance of caution" belief risk leaving one exposed to loss of wealth through higher inflation.

Hence, if I were borrowing at the moment, I would continue personally to hang out for a three year rate of 4.99% or better.

What about if I were an investor? I tend to avoid that question for legal reasons and because whereas most borrowers are the same, every investor is unique. But in general terms, I'd have a bias towards inflation hedges. You can figure out what that means for yourselves individually.

This week wholesale interest rates first fell away a bit then rose today back to about where they were last week as signs emerged of a backdown by the US President (again) on his tariff determination.

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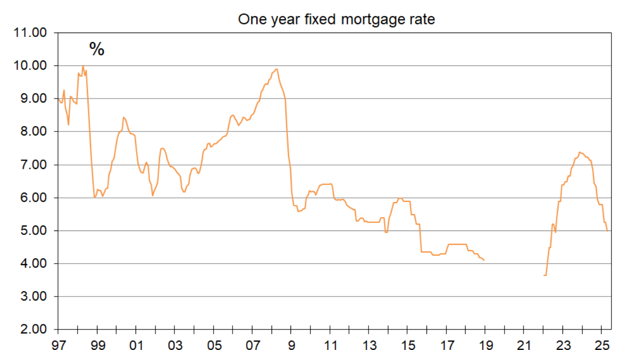
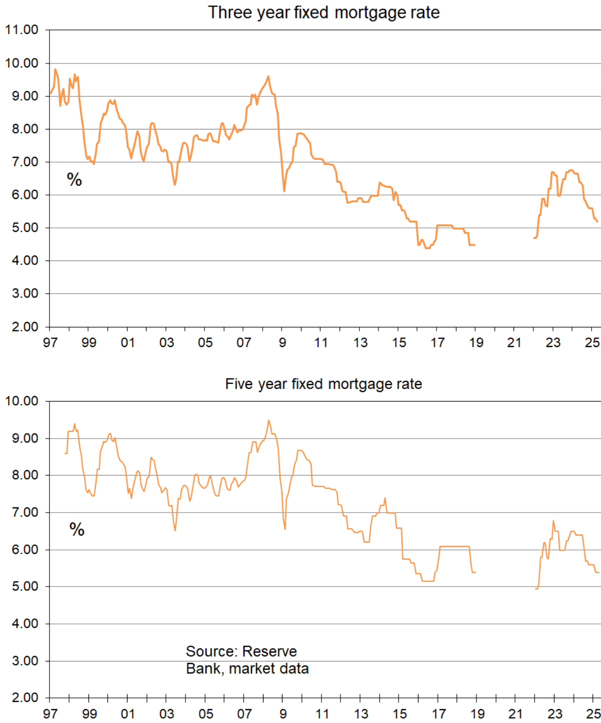
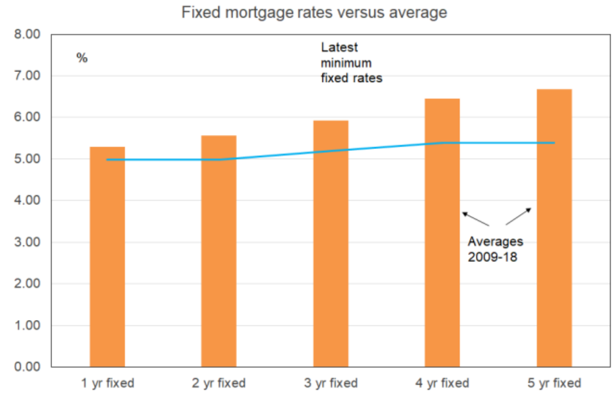
These three graphs show mortgage rates since 1997 excluding the period of deflation worries (2019) and the pandemic.





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

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