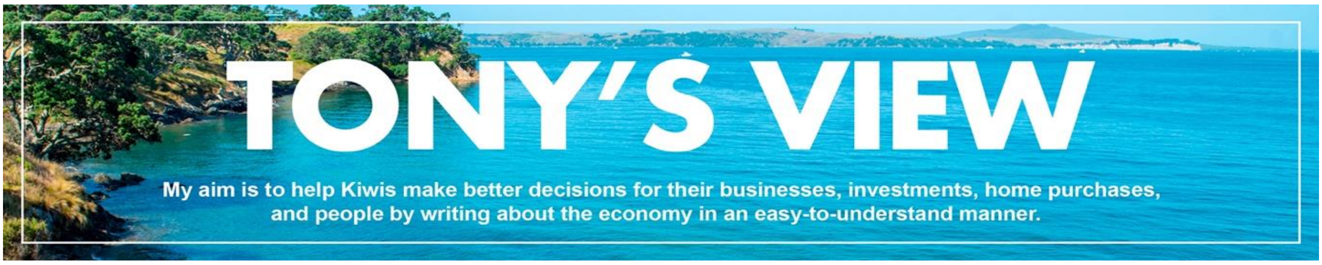

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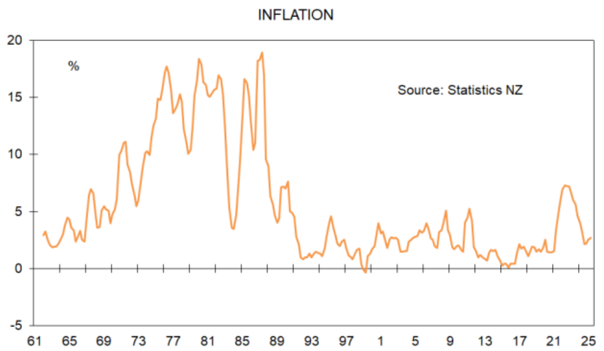
Inflation not horrible

The highlight on the statistics calendar this week for New Zealand was the June quarter Consumers Price Index which was released on Monday. The general expectation had been for a 0.8% quarterly rise and 2.9% annual rate. Thankfully, things turned out better than that with a 0.5% rise for the quarter and 2.7% change from a year earlier.



The 0.5% rise was exactly what the Reserve Bank had been expecting, so the outcome leaves the door open for another cut in the official cash rate after the last review produced no change.

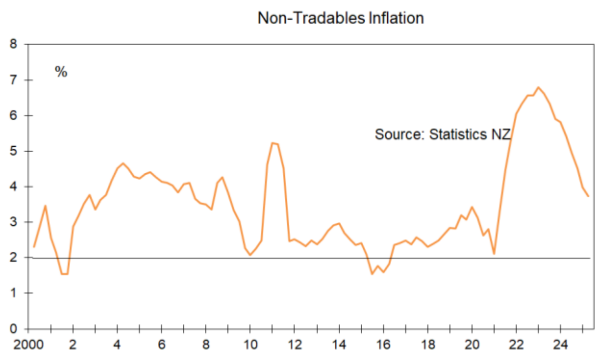
However, with the economy having shrunk by 1% over the past year the problem is this. Once growth lifts it seems reasonable to expect inflation will as well and that we could easily see the rate consolidate above 3%.

For that reason the Reserve Bank is unlikely to be thinking in generous terms come the next cash rate review on August 20. Scope for some minor falls in wholesale interest rates following the CPI result is there but they are likely to be small. That means scope in the near future for lower fixed mortgage rates is still fairly low. That in turn means strength in the housing market is still likely to be fairly mediocre over the next 12 months.

As regards the detail of the inflation number, I see no point going into specifics here as they will already have been well covered. I tend to stick to looking at the various underlying measures to see if there is anything to be concerned about.

The measure excluding food and household energy rose 0.4% in the quarter and 2.7% for the year. Nothing interesting there.

The non-tradeables measure which contains items not imported or exported and unaffected by world market alterations rose 0.7% in the quarter and 3.7% the past year. This is a tad high but almost equal to the average annual change for this measure since 2000. So, nothing to get excited about there.

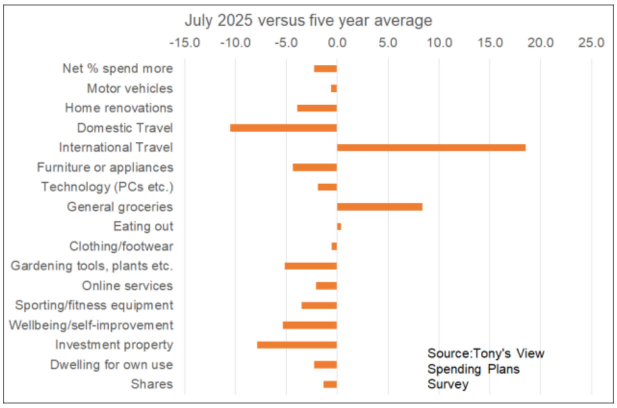


The trimmed measure which strips out the top 10% of things rising in price and the top 10% falling went up by 0.5% in the quarter and 2.6% in the year. Meh.

All up we are left with what I wrote a few paragraphs back. If 2.7% inflation is the outcome we get after the economy shrank 1% in the year to March and grew just 1.4% the year before that, how confident can we be of comfortably staying below 3% once growth gets back towards the long-term average of 2.7%?

Spending plans versus average

Just to get a feel for where greatest areas of household spending weakness lie, I have constructed the following graph. For each of the categories in my monthly Spending Plans Survey I calculate average net spending intentions since the survey started in June 2020. I then compare the latest results from three weeks ago with that average.



Overall the net spending intentions measure of -9% is 2% below average. Domestic travel spending intentions are well below average but those for going offshore are well above. People have a strong desire to spend some time out of New Zealand – though note that the average for this measure is biased downward because of the closed borders period.

Investment property buying intentions are especially weak and that is one of the key things I am trying to highlight currently. Almost all gauges of interest in investment property focus on the demand side. But there are many existing investors who are looking to sell for a wide variety of reasons. These include higher costs for insurance, rates, and maintenance along with changes in rules to favour tenants. Reduced long-term capital gain expectations are probably also playing a role.

Note that eating out plans are about average. That is not good news for the many thousands of people working in the sector running cafes etc. They are currently struggling and that is with spending intentions about normal.

Watch the lags

At the moment there is a general air of despondency in the economy. Young and middle aged Kiwis are shifting to Australia, business margins are tight, new customer growth is minimal, lots of restructuring and refocussing is having to be done, and house prices are falling.

Just under a year ago I warned in fairly strong terms that the economy would not boom just because restrictive interest rates were being removed. That message does not need to be repeated any longer because people can see the weakness around them.

So, what is it now that people need reminding of if not the ineffectiveness of interest rate cuts in delivering easy economic growth? Reasons for hope.

The economy is not munted even though many people think it is. We have been in this position before and what tends to happen is that people miss the strengthening factors which are working their way through the system and eventually will produce a reasonable growth environment.

Here are some of those factors in play which will likely produce more comfortable trading conditions from the second half of 2026. In other words not now, but not a tremendous distance down the track.

Higher business investment

The most recent ANZ Business Outlook survey shows that a net 20% of businesses plan raising their capital spending in the next 12 months. This is well above the 6% long-term average and is backed up by results of my own survey showing intentions of investing especially in digitisation and AI.

Lagged effect of higher export prices

Higher incomes for farmers courtesy of the average 15% rise in commodity prices over the past year do not immediately feed through to the rest of the economy. Famers first of all pay down debt and after that will initiate some higher spending.

The effects of this higher spending show up first of all in the regions and especially Invercargill and Dunedin. Then Christchurch plus the Bay of Plenty, Waikato, and Taranaki regions feel it. After maybe 12 months Auckland sees some strength and maybe after 18 months Wellington notices something has happened.

This process has only just started getting underway but will be relevant for higher urban activity levels through 2026.

Lagged effect of easing monetary policy

Just as it takes 18-24 months for a tightening of monetary policy to have its biggest impact on business pricing power and inflation, so too does an easing take 18-24 months to boost sentiment and spending in a sustainable manner.

The 18-24 month lag from the true tightening of policy in November 2022 (OCR up 0.75% and recession warning from the RB) saw an economic crunch in the middle of 2024 with our economy shrinking 1% in each of the June and September quarters.

Monetary policy started easing in New Zealand in August 2024 and rates have been cut reasonably steadily since then though without a shock and awe 0.75% change. The main benefits can reasonably be expected to start showing through in the period from March to August next year.

Higher infrastructure spending

New Zealand has an infrastructure deficit, and the government appears determined to do something about it. Increased spending on infrastructure will provide some underpinning to economic activity for many years. The boost however will not necessarily be large in any particular time period.

Export education

There remains considerable scope for numbers of foreign students studying in New Zealand to increase in coming years. Accommodation capacity exists in Auckland particularly and Australia is trying to decrease foreign student numbers to address housing issues.

If I were a borrower, what would I do?

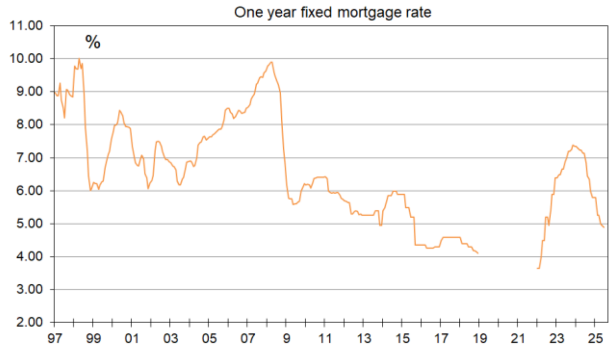
A state of confusion reigns with regard to exactly where growth, inflation, and interest rates are headed in the United States. That coupled with the approach of the end of our monetary policy easing cycle means one cannot make any strong statements regarding what our interest rates are likely to do.

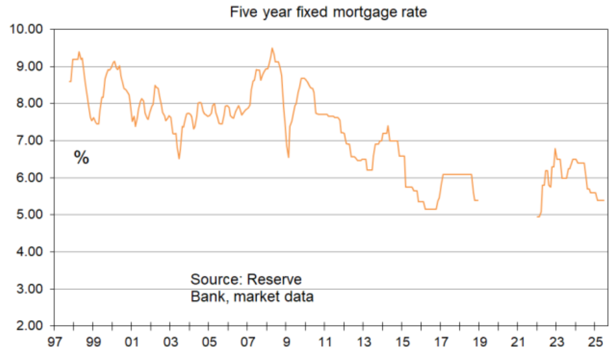
The chances are we will see only minor fluctuations in wholesale rates and therefore fixed mortgage rates here over the remainder of this year and much of next year. That means this section in my weekly document could be quite small for a long time going forward.

This week rates didn't change much from where they were a week ago – just down a tad.

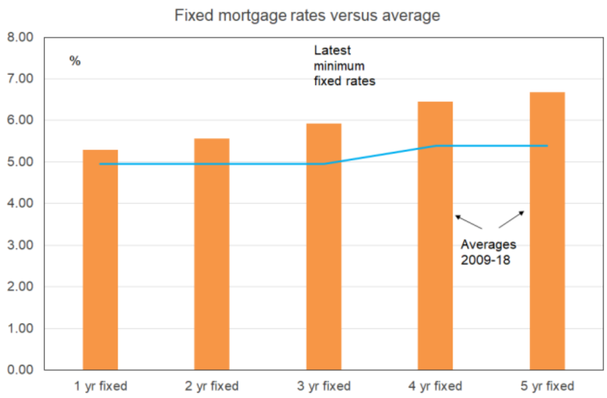
If I were borrowing at the moment, I'd personally opt for fixing three years at 4.99%.

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.