TONY'S VIEW

My aim is to help Kiwis make better decisions for their businesses, investments, home purchases, and people by writing about the economy in an easy-to-understand manner.

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25 January 2024

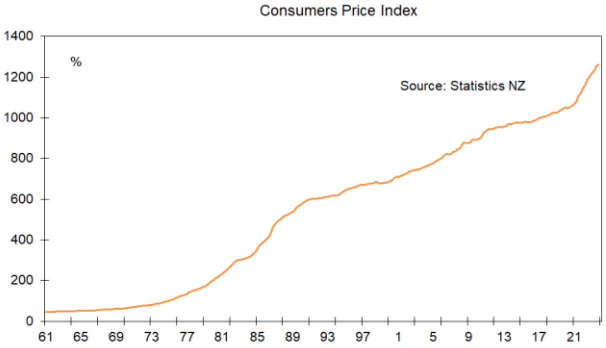
Inflation falls – but still too high

The key piece of news relevant to the New Zealand economy, interest rates, and the housing market this week came out yesterday in the form of the quarterly Consumers Price Index.

Every three months Statistics New Zealand surveys the prices of almost 650 items which Kiwi households tend to consume on average. They alter the basket of goods over the years to take out and reduce the percentage weighting of things we buy less and less of, like CDs, and increase the weighting and put in things we buy more of, like online services.

All the numbers are added together to produce an index which was set at 1,000 in the March quarter of 2017. Inflation is measured as the difference between this index in one quarter compared with another. For instance, in the March quarter of 2018 the index was 1011 therefore inflation for that year was 1.1%.

The graph of the index looks like this but it's not really of any use to us economists because it is the change we are interested in and not the index level as such.



The change in the index can roughly be read as a measure of the change in our cost of living although no two households are the same and we can only talk in averages. In particular, the CPI does not include interest costs, so over short time periods it is more accurate as a measure of the change in living for the two-thirds of households who do not have a mortgage than the one-third who do.

Nonetheless, we can roughly say that the cost of living for the average Kiwi household has risen by 21% since the end of 2019 just before the pandemic got under way. I like to reference this time period because people talk misleading in terms of a cost of living "crisis". But, since the end

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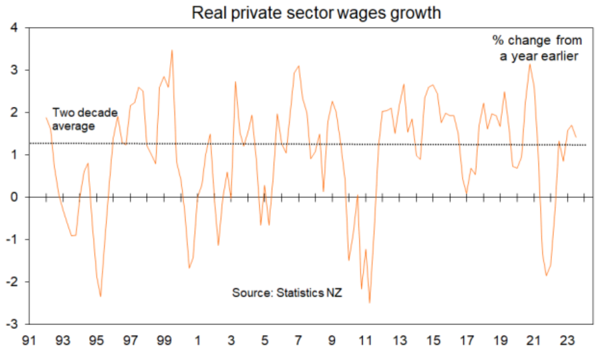
of 2019 average wages in New Zealand have risen some 25%.

Real, meaning inflation-adjusted, wages have risen on average 0.9% a year over the past four years which is only just below the average real wage gain for the past two decades of 1.2% a year. The cost of living pain is largely being felt by those people who have not gained good wages growth these past four years.

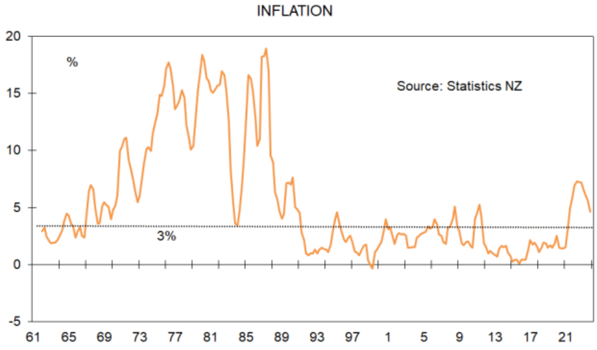


But that issue aside, what we learnt yesterday was that the CPI rose to an index reading over the December quarter 2023 of 1259. The index in the September quarter was 1253 therefore on average in the December quarter consumer prices rose by 0just under 0.5%. This was less than the 0.8% expected by the Reserve Bank but bang on market expectations.

A year ago the index reading was 1203 so the country's official inflation rate is now 4.7% compared with 5.6% before the release, a peak of 7.3% in June quarter 2022, and the average rate since 1992 of 2.3%.

Does the lower than RB expected result and decline to the slowest pace of inflation since June quarter 2021 mean monetary policy will be imminently eased? No, for a number of reasons.

First, at 4.7% inflation is still well above the Reserve Bank's target range of 1% - 3%.



Second, a key driver of inflation is wages growth and there is as yet a lack of evidence showing that growth slowing rapidly in response to the record net migration surge, weak business labour demand, and the easiest labour-sourcing conditions for firms on average in 14 years

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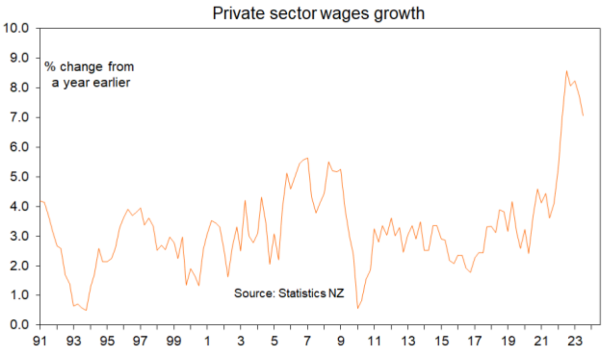
according to the NZIER's Quarterly Survey of Business Opinion recently released.

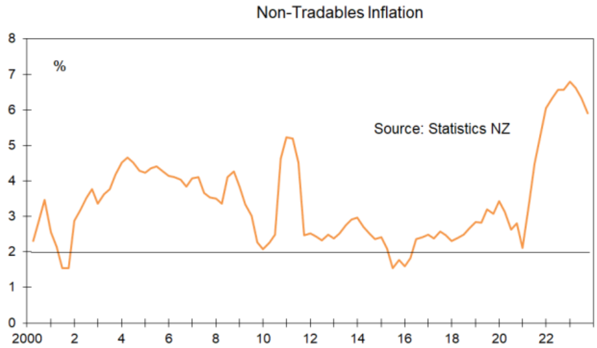

Private sector wages growth

Source: Statistics NZ

The Reserve Bank will want proof of much slower wages growth before signalling an imminent easing of the official cash rate from the 5.5% level they took it to in May last year.

Third, some of the underlying measures of inflation are still much too high. For instance, while average prices of things traded across the border (tradeables) fell 0.25% in the December quarter to lie just 3% ahead of a year ago, prices of domestic-focussed things (non-tradeables) rose 1.1% in the quarter (4.4% annualised) and 5.9% in calendar 2023.

The tradeables inflation measure can get whipped around by movements in offshore inflation, oil prices, and the exchange rate. But domestic, non-tradeables, inflation tends to more reflect the inflation-producing conditions in the economy upon which monetary policy acts.


Non-Tradables Inflation

Source: Statistics NZ

At 5.9% non-tradeables inflation is still well beyond the pale.

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I could go into greater detail with discussion of inflation excluding food and energy (a popular measure in the US), the trimmed measure which excludes the top and bottom 10% of price movers, and details of the near 650 items. But such discussion would not change the conclusion above.

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Inflation remains too high still in New Zealand for any immediate easing of monetary policy.

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However, with many indicators suggesting

- weakness of late-2023 continuing into the first half of this year,
- still falling dwelling consents and below average consumer sentiment,
- tightening fiscal policy, and
- rapidly easing labour market,

the financial markets are likely to continue pricing in an easing of the OCR from about the middle of this year or thereabouts.

We should not be surprised that when the announcement of an easing comes from the RB it will probably be a surprise.

In case you missed it

On Tuesday I released my latest monthly Regional Property Insights report written for First Mortgage Trust. I look at how average house prices have changed in each region since May 2023 and how prices compare with a theoretical measure of long-term trend.

https://fmt.co.nz/wp-content/uploads/2024/01/RPI-January-2024.pdf

Yesterday I released results from my first monthly survey of mortgage brokers for the year, sponsored by mortgages.co.nz. The main themes to come through from the statistical and anecdotal responses include these.

- Banks are slightly easing lending criteria for first home buyers.
- Anticipation of more buyers coming forward is encouraging some people to try and make their purchase now rather than waiting.

mortgages.co.nz & Tony Alexander Mortgage Advisers Survey - January 2024 - mortgages.co.nz

If I were a borrower, what would I do?

The inflation number released yesterday was overall slightly worse than expected for the underlying non-tradeables measure. As a result wholesale bank borrowing costs edged up slightly but remained well within trading ranges of recent weeks.

The one year swap rate at which banks borrow fixed one year in order to lend out to home buyers fixed for one year rose to around 5.34% from 5.28% last week. The three year rate edged up to near 4.5% from 4.46%.

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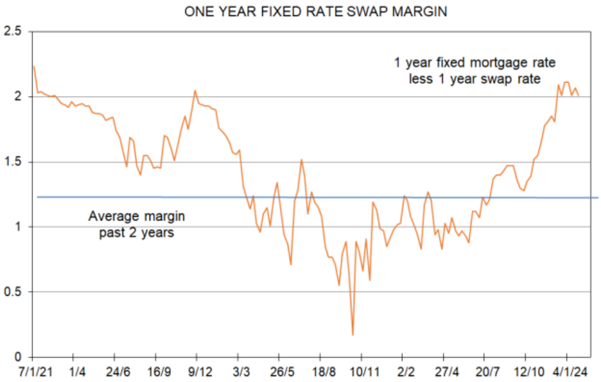
These rates still leave bank fixed rate lending margins at well above average levels so in theory considerable scope exists for fixed mortgage rates to be cut.



But in practice banks are unwilling to challenge the Reserve Bank's desire for continued high rates regardless of the downward pressure from falls in interest rates offshore. They probably also like the extra profits which the high rates are delivering for now. Heck, maybe they are building up war chests of funds to be used for securing more business and market share when competition once again rears its head!

If I were borrowing at the moment I would either float and wait for lower rates or do what I tend not to favour because of the hassle and fix for just six months.

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.

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