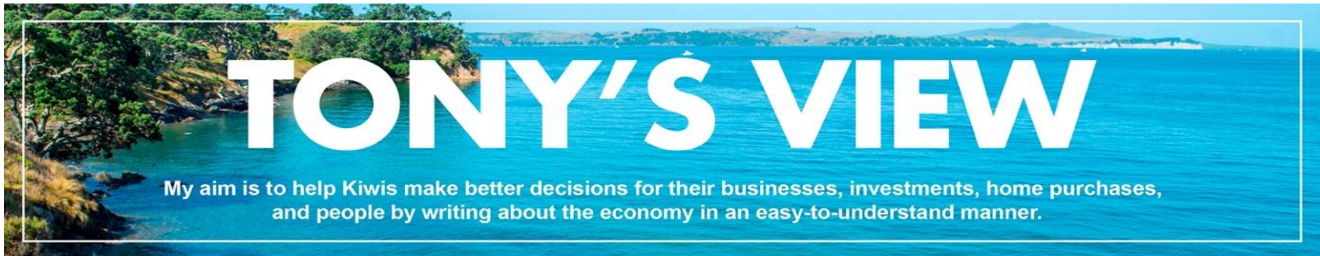

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Slow growth ahead

There are two key themes which I have been trying to get across to people for the past few months. They are that the speed of recovery in our economy will be muted and talk of a "rockstar" economy is ridiculous. Recall that I wrote "you won't thrive in '25" and "You'll have to wait for '26 to get your fix."

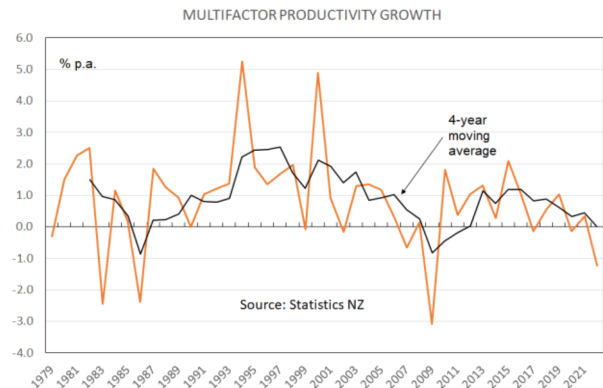
I've also been pushing the theme that interest rates will not fall as far as many are hoping, primarily but not solely because the cyclical recovery in inflation risks coming early.

The Reserve Bank yesterday did what NZ Treasury did last week and hosed down any expectations for strong economic growth with some substantial downward revisions to their GDP growth projections without any concomitant reductions in their inflation outlook.

In their August Monetary Policy Statement they predicted that the NZ economy would grow by 2.7% in the year to March 2026. Now they predict just 2%. In the year to March 2027 they picked 3.2% growth. Now they predict 2.4%.

But for these same time periods they have lifted their inflation forecast for March 2026 from 2.1% to 2.3% and for March 2027 from 2.0% to 2.1%.

Slower growth, higher inflation. This is what you get in an economy bereft of productivity growth – early onset inflation when growth returns and higher average inflation for any given economic growth rate than with good productivity growth.



This is the dynamic I was trying to highlight in the article I wrote which stretched over my August 22 and August 29 editions of Tony's View and Tview Premium.

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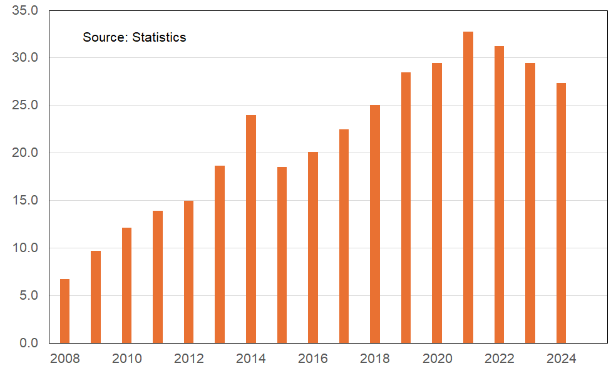
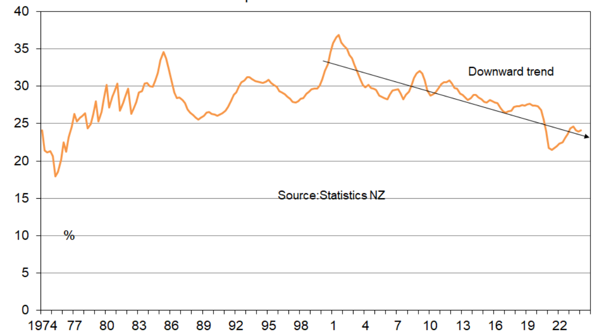
We are not a rock star economy and at best may be folk singing. As an electorate we have voted against changes aimed at radically altering the fundamental nature of our economy since 1992. As a business sector we have failed to develop the many new large exporters which NZTE long hoped for with their efforts from many years ago.

And we have proven that we do not have the ability to turn our simple milk production sector into a thriving consumer-branded business like Nestle. Fonterra have thrown in the towel on that front.

Then it gets worse. 27% of our export receipts come from China but the outlook for China's economy is not good. Their population is shrinking and aging, people have lost capital in the property market, the government has undermined free market forces, foreign businesses are shifting out, and the incoming US President is set on further undermining China's economic strength and its impact on the US manufacturing sector in particular.



We have benefitted greatly from the Chinese economy over the past one-two decades. But we have now moved past peak China though it is not clear that we have moved into new thriving markets. India offers strong potential, maybe in the second half of this century.



Our own manufacturing sector has been on a long-term decline and continues to worsen with

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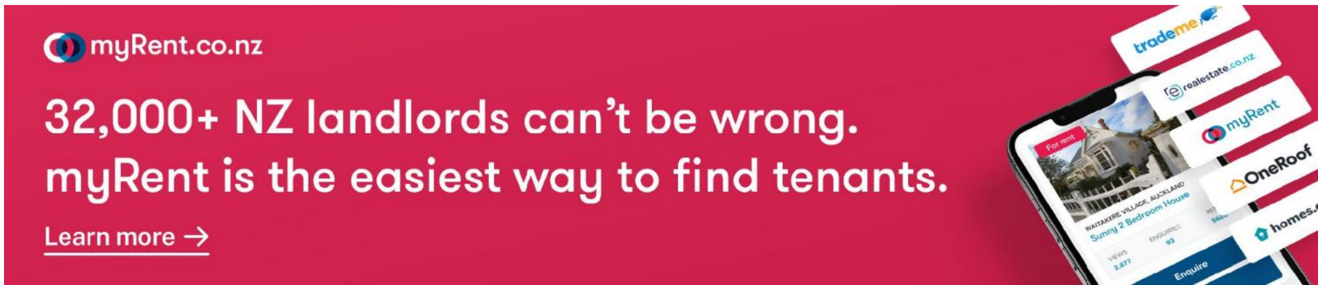
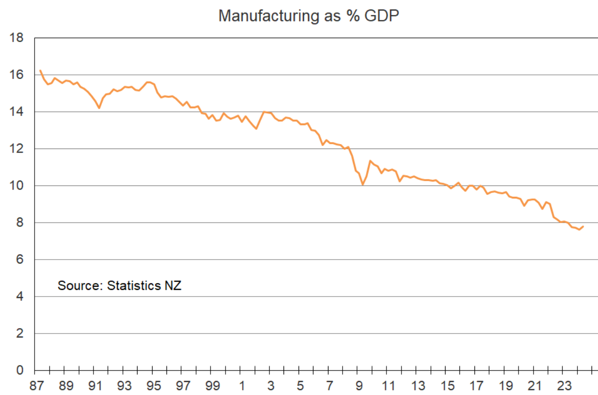
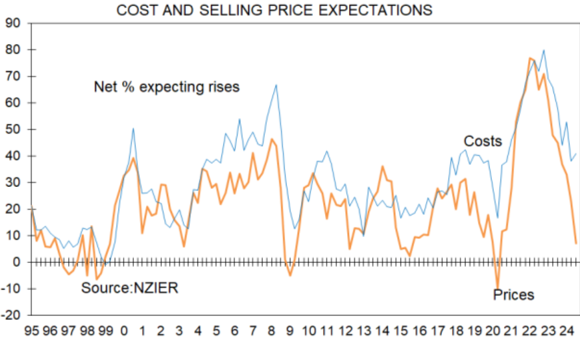


recent announcements of closures in the wood sector. Businesses like Rakon are shifting production offshore. All businesses now need to give greater thought to whether the electricity they may need for current production levels let alone higher ones will be available in future years, and what the cost will be. The incentive to remain and expand in New Zealand has deteriorated for electricity users this year.



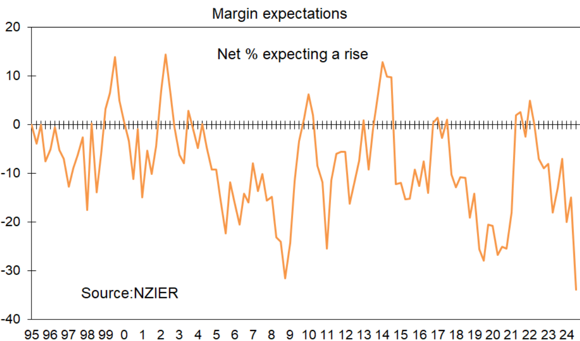
There are extra costs to come to our economy as a result of climate change. The pastoral sector is shrinking as land is converted to locking carbon into bio-diversity and community destroying pine forests.

There is also intense pressure on business margins best seen in two key results from the NZIER's Quarterly Survey of Business Opinion. Recently only a net 7% of businesses which they survey said that they will raise prices over the next three months. This is below the three decade average of 21% and down from 45% a year ago. This is why monetary policy is easing rapidly.



But a net 41% of businesses say that their costs are expected to rise in the next three months. This is above the 29% three decade average and only down from 58% a year ago.

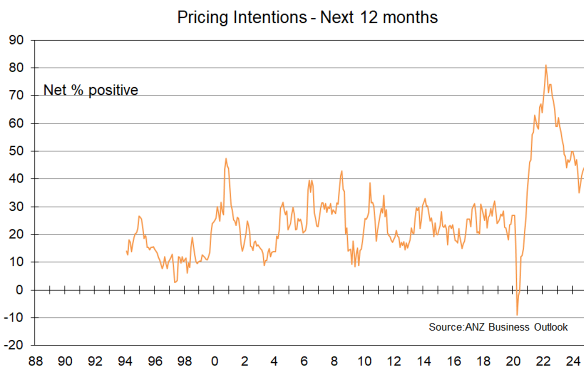
There is a margin squeeze underway which when measured by the simple deduction of cost from pricing expectations is at its worst levels since 1976.



Many businesses have yet to be weeded out from our economy across all sectors and as they close or amalgamate the pace of our growth will be constrained.

But of relevance to my earlier comment about the cyclical recovery in inflation is the ANZ Business Outlook Survey where businesses are asked about their pricing plans 12 months from now – not three months.

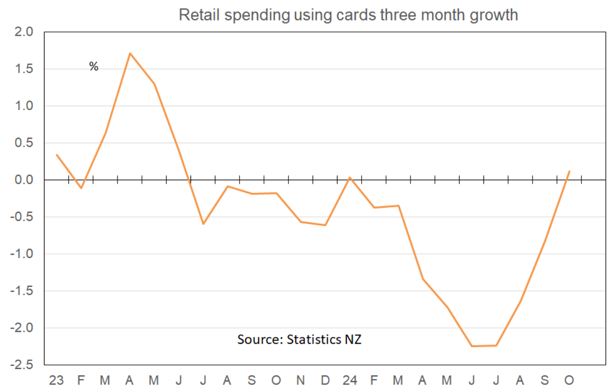
With a very high net 66% of businesses expecting the economy to be stronger a net 44% say they plan to raise their selling prices. This is above the net 26% three decade average for this measure and up also from 35% four months ago.



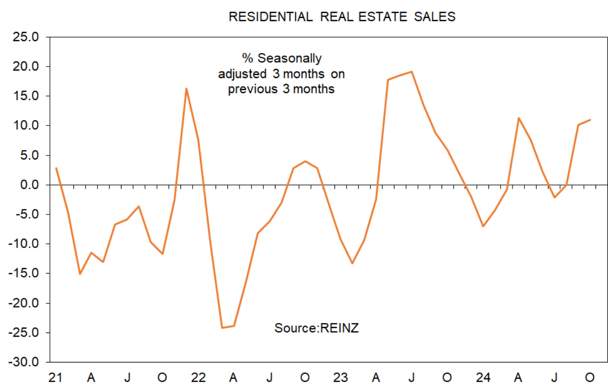
There is inflation lying in the wings ready to emerge when businesses see strong consumer spending. The lift in business prices will add to inflation, as will the already announced plans for higher electricity prices, and higher council rates. Note that because many large sectors in our economy are dominated by a small number of firms the inflation risk is heightened as their oligopolistic structures allow pricing which is not possible in sectors with very many medium-sized operators.

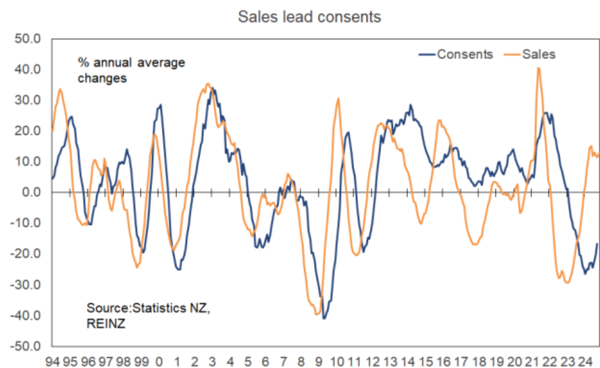
Despite my strong words of caution not to expect a boom in our economy anytime soon, and despite the deteriorating global trading environment and many risks in play, there are signs of recovery in NZ activity from low levels.

The trend in spending using debit and credit cards is upward – barely.

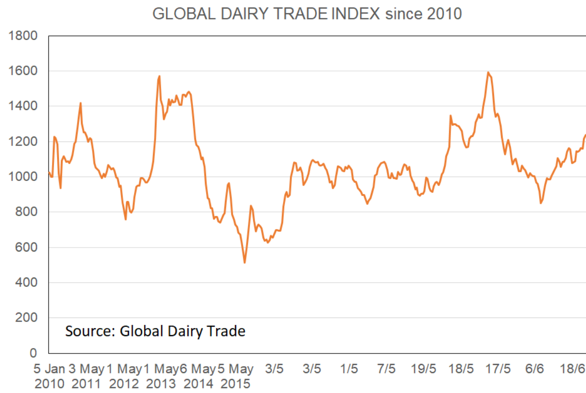


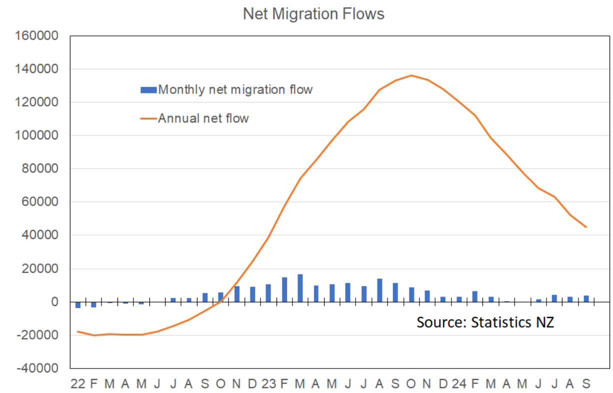
Residential real estate activity is firming, and this tends to precede stronger activity in house building.





Above average net proportions of businesses plan to boost their capital spending and their hiring in the next 12 months. Plus there is a little stimulus underway from slight weakness in the NZ dollar. The lift in dairy prices is also not to be sneezed at with the Global Dairy Trade Index ahead 26% from a year ago.





So, a recovery is underway with assistance from the removal of interest rate restraint. But with the Reserve Bank estimating (guessing like the rest of us) that the neutral cash rate lies somewhere between 2.5% and 3.5% and with them predicting a 3.1% low for the cash rate, we are not looking at an environment of actual monetary stimulus.

That is, the foot is coming off the brake, but it is not going to be placed on the accelerator. This will limit not just the speed of upturn in our economy (in order to keep inflation in check) but also the extent and speed of price gains for the upward leg of the house price cycle.

I haven't said anything about net migration flows because these are impossible to accurately forecast. Just because we have fallen from a net gain in the year to October 2023 of 136,000 to 44,000 in the year to September 2024 does not automatically mean we are headed firmly negative by mid-2025. Anything is possible and if extrapolation of the trend is what you want to do in order to generate a prediction, I would focus on the most recently monthly average flows and not the year ago change.

Those monthly flows are suggesting a bottoming out of the decline is currently underway.

Oh, and at yesterday's release of their newly downbeat economic forecasts the Reserve Bank also cut the official cash rate by 0.5% to 4.25%. This was universally expected by economists though some investors had priced in a 0.75% reduction. That is why wholesale interest rates edged up a tad yesterday along with the NZD. Yes, you can get a currency rise following an interest rate cut. It all depends upon what was anticipated by those taking market positions – which is not us economists.

If I were a borrower, what would I do?

Wholesale interest rates fell slightly this week, mainly in response to some easing back down of yields in the United States. This decline was slightly reversed after yesterday's cash rate review where the rate was cut 0.5% as we economists expected, but not as everyone in the markets had positioned for.

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Some people had bet on a 0.75% cut which meant after the smaller change was announced they closed out positions and rates crept slightly higher.

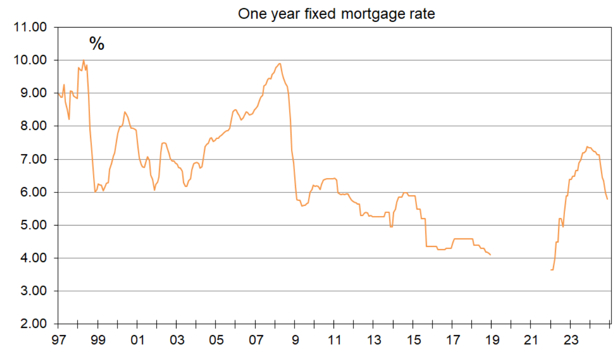
The one year swap rate now sits near 3.83% from 3.93% last week and 3.87% four weeks ago. The three year rate is near 3.63% from 3.76% last week and 3.58% a month ago. The five year rate is near 3.73% from 3.89% last week and 3.74% a month back.

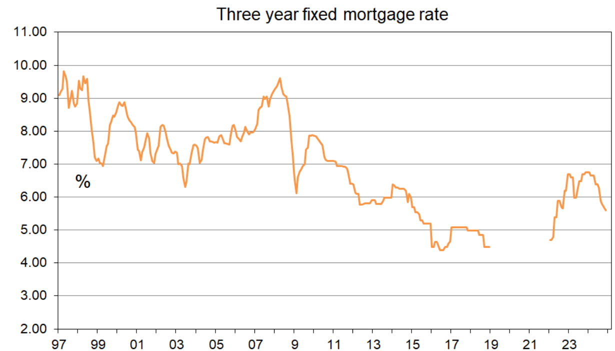
You can see that OCR cuts now are mainly causing just short-term wholesale borrowing costs to decline. Scope for rates three years and beyond to go lower is still there – but it doesn't look like the magnitude will be all that much.

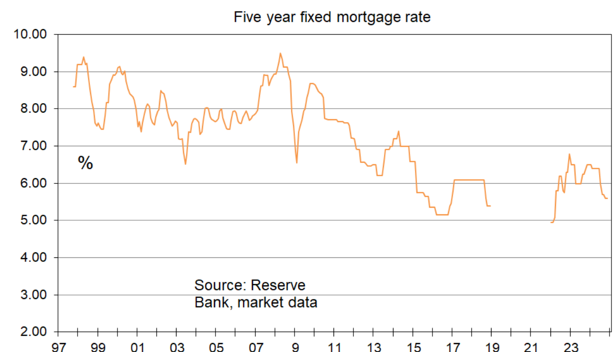
It pays to note that there is a lot of uncertainty about how these rates will track for the next few months – in fact for the next 4+ years of Mr Trump's second US Presidency. Borrowers should explicitly recognise this environment of heightened uncertainty and look perhaps a tad more favourably at medium to long term rates to hedge against it than would otherwise be the case.

In response to yesterday's cash rate cut the banks have cut their floating mortgage rates by 0.5%. But cuts to fixed rates have been minimal with the one year rate going down about 0.2% and the three year rate about 0.06% (not 0.6%).

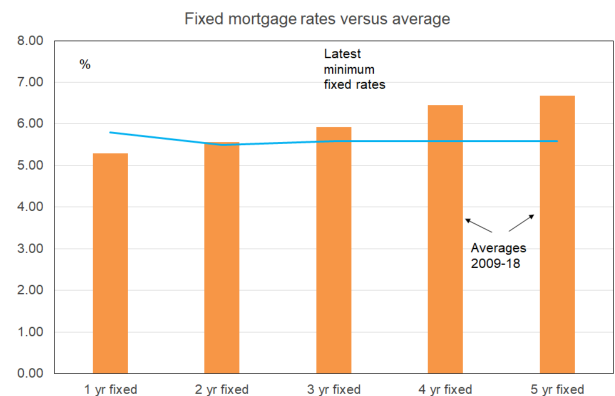
These three graphs show levels of the one, three, and five year fixed mortgage rates over the past few years excluding the 2019-21 period when rates were absurdly low because of worries about deflation and then the effects of the pandemic.







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



I reckon scope exists for the 3-5 year fixed rates to be cut further once banks start more assertively competing for business. For the moment I don't think they are really feeling it. So, I'd still probably fix for a short-term (six months though some feel 12-18 is good), with a view to fixing 3-5 years probably sometime next year. When is anyone's guess in this very uncertain environment.

To see the interest rates currently charged by major lenders go to www.mortgages.co.nz

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