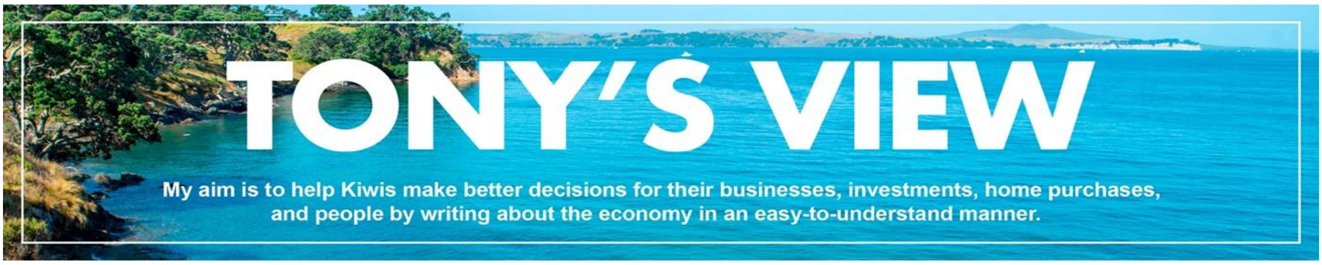

Input to your Strategy for Adapting to Challenges

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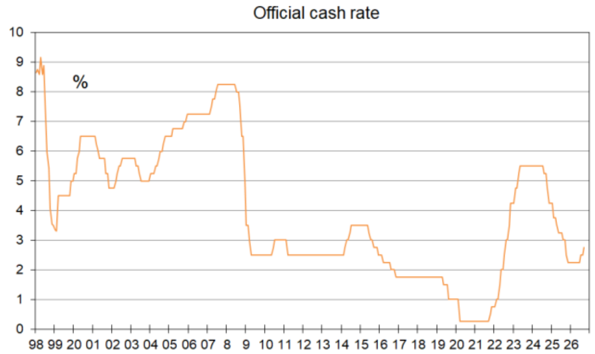
Monetary policy tightened as expected

As had been near universally expected the Reserve Bank raised its official cash rate 0.25% to 2.75% yesterday and produced a forecast track for the rate about the same as in May. They see the peak at 3.25% but noted that considerable uncertainty exists about where inflation will head.



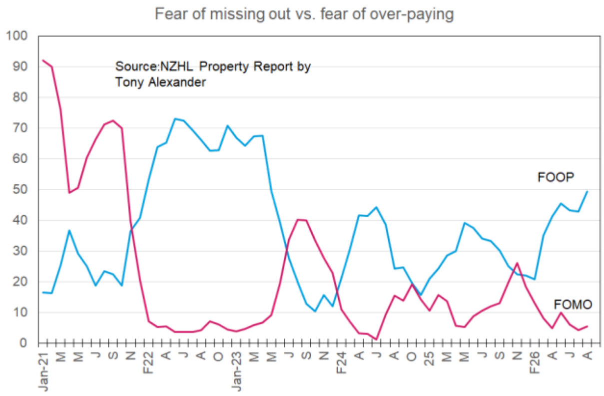
They are counting on inflation falling as the pace of growth in the economy accelerates, but anything could happen with regard to the two wars underway. The outlook for fuel prices therefore is uncertain.

Highly uncertain also is the key area I am keeping an eye on – businesses eventually taking advantage of the economic upturn to rebuild their margins. We are not in a strong enough growth environment yet for that to happen and won't really get an answer on this until well into 2027.

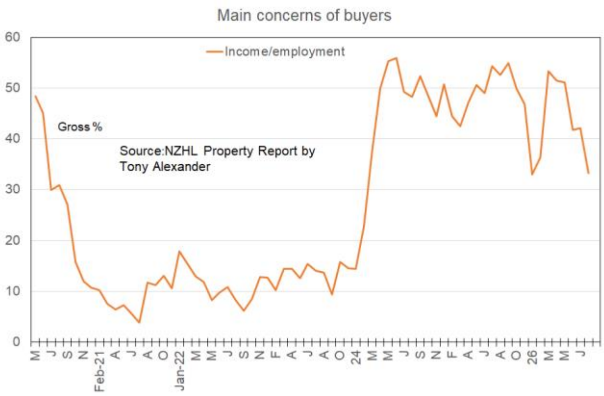
Agents see a flat real estate market

This week I have run my monthly survey of real estate agents around the country, sponsored by NZHL. In a nutshell the results are very similar to those of the previous survey at the end of July. First home buyers are active, investors are scarce on the ground, buyers back away quickly from any properties with "issues" townhouses are not favoured and there is awareness of an oversupply.

A solid buyer's market remains in place, prices on average around the country are falling, and FOMO is dead as. There is caution about what may come out of the election, mild apprehension about interest rates rising, growing worries about falling prices (fear of over-paying, FOOP), but one interesting positive development worth focussing on.

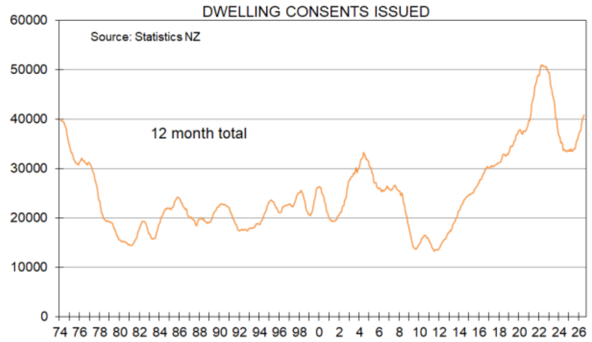


The proportion of agents saying that among the list of things buyers are worried about employment is one of them has fallen to 33% from 42% last month and a peak of 53% at the end of March. This is the best result since February 2024 and tells us that it will be worth keeping an extra eye on employment data in the near future because firms may be doing more hiring than is generally being discussed in the media.



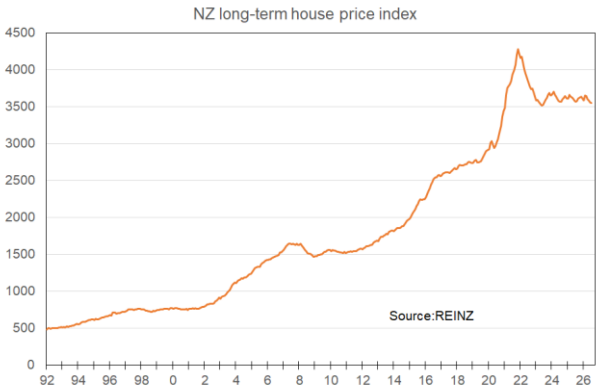
Employment confidence is going to increasingly be one of the key factors influencing New Zealand's housing market now that the role of investors has structurally declined.

Another area of structural change is house supply. In the year to July the number of consents issued for the construction of new dwellings around the country was 40,700. This was a 21% rise from a year ago and the highest annual total barring the pandemic binge since 1973.



There is less and less talk of housing shortages these days and that means reduced feelings by people that they need to buy as soon as possible. Young buyers are going to be able to save up a deposit over a longer period of time without having to fret about prices running away on them.

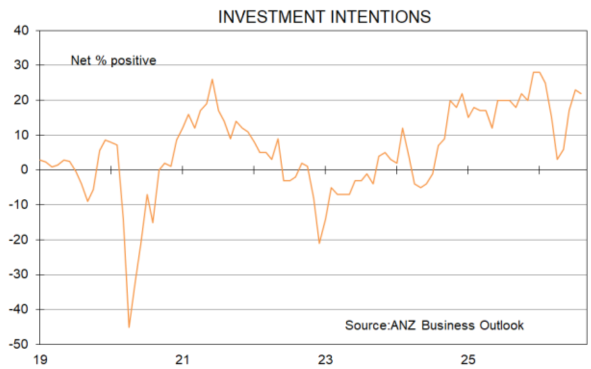
NZ average house prices have basically been flat since the June quarter of 2023 when they ended a 16% fall from the covid peak of late-2021. Prices now are about 23% higher than immediately before covid in 2020.



Business confidence strong

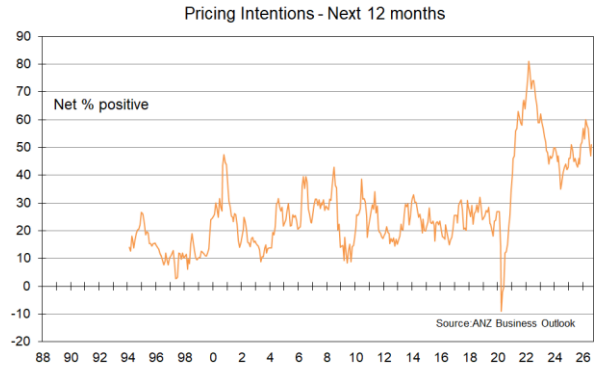
This week ANZ released their monthly Business Outlook survey which showed confidence about the upcoming year holding high at a net 54% positive from 56% last month.

Employment expectations remained above the ten year average of 7% with a reading of 19% while investment intentions of a net 22% positive were above the average of 11%. Basically the numbers are good and tell us that businesses expect and are planning for better times ahead.



However, what would have been really interesting is if the decline in the net proportion of businesses planning to raise their selling prices of the past four months had continued. It did not.

In this latest survey a net 51% of businesses said they are planning to raise their selling prices in the coming year. This is up from a net 47% a month ago but down from the war-induced peak of 60% seen in March.



These pricing plans continue to track at above average levels and as noted here a couple of months ago have belatedly attracted the interest of the Reserve Bank. They are worth monitoring but for the moment one suspects the still generally challenging conditions in many sectors will leave many businesses wanting to raise their selling prices but unable to do so because of competitive forces.

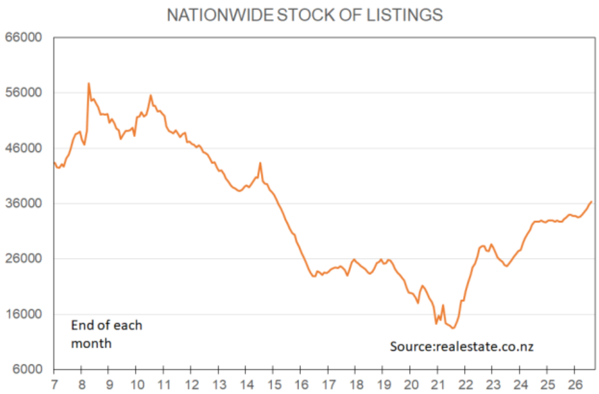
Such forces do not exist in some sectors such as the provision of council services. Each council is a monopoly and the rule in economics is if there is a monopoly you need regulations put in place to prevent them from extracting profits solely from that monopoly status.

With regard to our local authorities we do not get monopolistic profits but instead monopolistic projects which get funded through monopolistic pricing. Thankfully plans are being put in place to restrict these monopolies from setting their own prices – at least to a minimum rise of 4% per annum. The case for bringing this rule in now is however strong and waiting until 2029 leaves a window for each council to ratchet their prices (rates) up as high as possible before their actions get restrained.

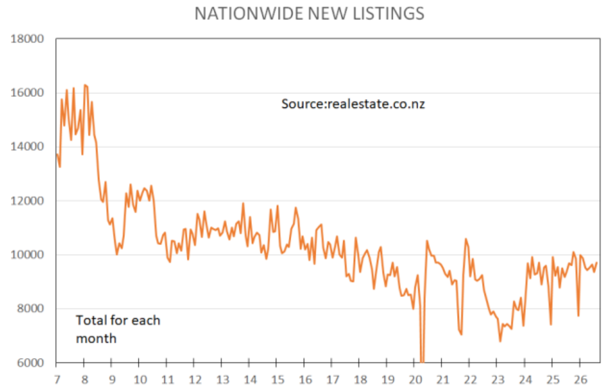
Property listings strong

Data released by realestate.co.nz this week tell us that in seasonally adjusted terms at the end of August there were 36,300 properties listed for sale around New Zealand. This was a rise of almost 10% from a year earlier and the highest level of stocks since February 2015.

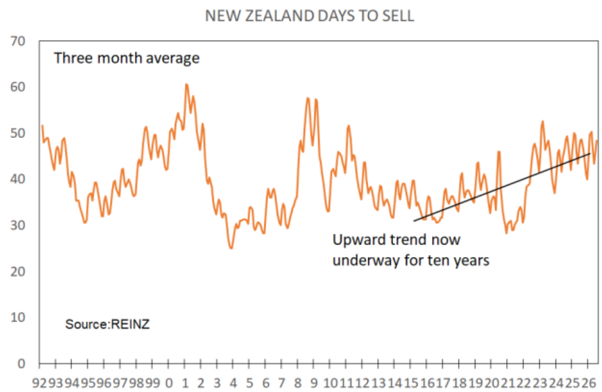
There are plenty of choices facing property buyers and the situation continues to move more in their favour. For sellers there is increased competition and that is why we are seeing a market pricing response in terms of average NZ house prices falling over the past five months.



In the month of August the number of properties newly listed for sale in seasonally adjusted terms added up to 9,700 which was about the same as a year ago. So, it is not the case that a flood of properties is hitting the market and instead the situation is one where properties are on the market but not selling all that quickly. Buyers are picking and choosing, making low offers, walking away etc.



The challenge for real estate agents lies on the side of convincing vendors that they need to be realistic in their setting of a price and their willingness to negotiate.



If I were a borrower, what would I do?

There has been upward and downward pressure on wholesale borrowing costs in New Zealand. Mild downward pressure came yesterday as the comments made about inflation risks and the need for rate rises ahead by the Reserve Bank were slightly less hawkish than expected.

But there was upward pressure on rates from a few outside important sources.

Australia's inflation data released last week turned out to be slightly stronger than expected and with the RBA Governor warning about the need for higher rates expectations are high for another policy tightening late this month.

Meanwhile in the United States the Federal Board Chairman has expressed greater than expected concern about where inflation is headed and expectations have lifted for a tightening of US monetary policy soon.

There has also been upward pressure on bond yields because of rising oil prices caused by fresh hostilities on the ground in the Middle East, plus higher than expected in Europe, and hawkish developments in Canada.

As noted for some time now, experience over the past four decades tells me that at the start of the NZ monetary policy cycle we all tend to under-estimate how high interest rates will go. There is usually a dominant line of thought which runs along the lines of this time being different.

But this time around there are many firms still in need of raising selling prices to rebuild crunched margins. The many sectors with oligopolistic structures remain and that means a strong upside risk to inflation once growth in the economy gets chugging.

It seems reasonable to think that councils will take the opportunity presented to them of a rates cap at 4% not coming in for three years to ramp up their increases to the maximum before then. Construction of data centres will push up electricity prices, and New Zealand's lengthening period of falling productivity levels (note, not productivity growth but its level) will naturally boost inflation for any given rate of growth.

The outlook is certainly not dire as in the central bank facing a strong probability of having to create a recession come 2028 in order to get inflation back in check. But risks for interest rates lie on the upside.

That is why I continue to favour a period for fixing my mortgage if I had one which would take me over the upside risk hump. Three years is my preferred fixing term for now. Once interest rates are higher that will change to a shorter term and I'll use phraseology along the lines of being in the ride now and having to take the pain in order to enjoy lower rates down the track. It is not possible to reasonably pick when that point will be reached.

Opps. Last week I said there was not a new set of economic forecasts coming out of the Reserve Bank with their rate review. But of course they have updated their numbers as this review included the Monetary Policy Statement. Too many balls to juggle.

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.