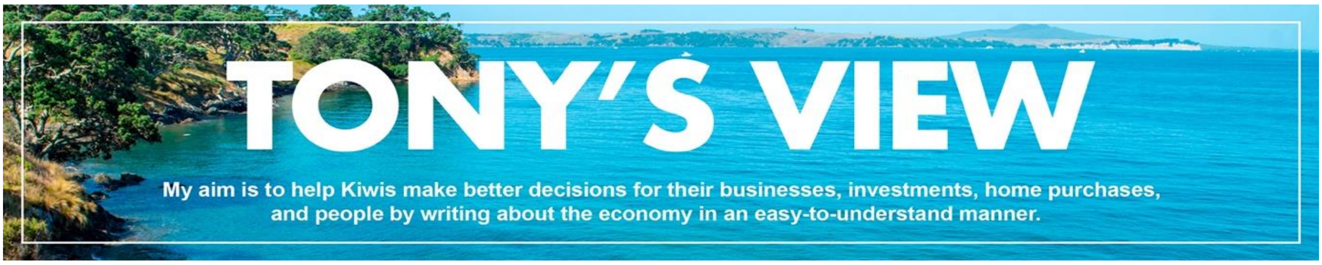

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Mortgage rates edging higher

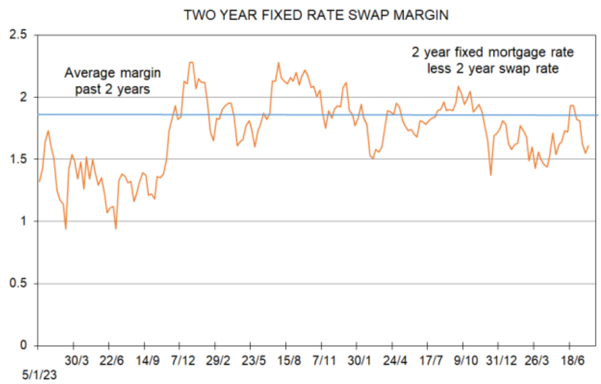
There is a round of fixed mortgage rate increases underway at the moment with the likes of the popular two year fixed rate shifted to 5.45% by the main mover. Other lenders have yet to move their rates up from around 5.29% but they probably will.

Having said that, earlier this year a large lender was left stranded when they tried to initiate a round of rate rises but no-one else followed. They eventually backtracked with assistance from a pullback in their borrowing costs.

The speed with which mortgage rate rises follow borrowing cost increases depends on the degree of desire amongst banks to protect or gain market share. Sometimes they all move quickly, sometimes they hold their horses for a while which is broadly what has been happening recently.

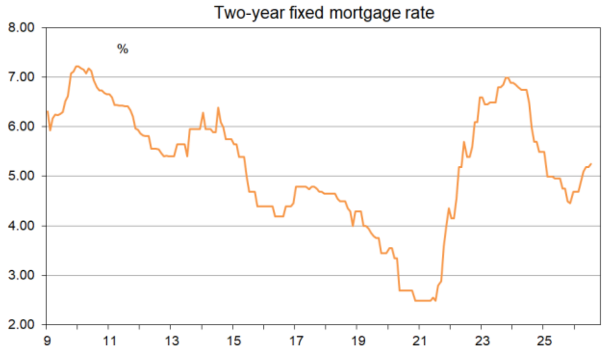
We can see this by looking at a rough calculation of the lending margin on two year fixed rate lending and comparing it with some chosen period of an average level – which may be relevant or not.

This graph shows the two year fixed rate margin using the best lending rate available from the main lenders. The blue line is the average for this margin over the past two years, and we see that the margin has been below this level for a few weeks now.



In fact, margins have been unusually low since the start of the year. Borrowers should think about that as they consider where rates are headed. A period of catch-up rate rises could prove painful for some.

At the start of this year the two year interest rate was near 4.69% and the cyclical low was 4.49% seen for a brief period in October.



Mortgage rates are rising because the cost to banks of borrowing money to lend fixed is going up. The two year wholesale borrowing cost (the swap rate) is currently sitting near 3.67% from 3.35% four weeks ago, 2.9% at the start of the year, and 2.5% in October.

The rates in the market today are slightly lower than they were a few days ago when one bank raised their mortgage rates and I wrote about it in my weekly column for OneRoof.

The small pullbacks across the yield curve yesterday came after the Australian inflation number yesterday came in 0.1% lower than expected and that has led to a scaling back of predictions for how rapidly the RBA will raise their cash rate further.

This reminds us that international developments have an impact on interest rates here and that is why people tend to keep an eye mainly on what is happening in the United States and Australia.

With regard to the US there has been upward movement in borrowing costs this year because the Fed has raised its cash rate and inflation has been boosted by surging oil prices – with the same thing obviously happening here as well.

Principally however the upward movement in NZ borrowing costs reflects the recovery underway in our economy (stalled over the June quarter) and expectations that as growth trundles along inflationary pressures will build.

As regular readers will know I have concerns about inflation this cycle and the risk that people are under-estimating how high mortgage rates may go. This early in an economic recovery inflation should be a lot lower than it is.

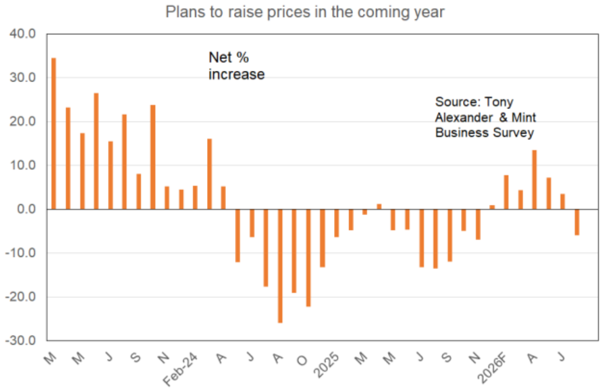
For instance as noted here recently, the rate of inflation for goods and services traded domestically and not across the borders – non-tradeables inflation – is currently 3.4%. But the long-term average is 3.5%. This rate Is unusually high considering the position of the economy.

It tells us that there is not much room for the economy to grow before inflation risks consolidating once again above the 1% - 3% target range.

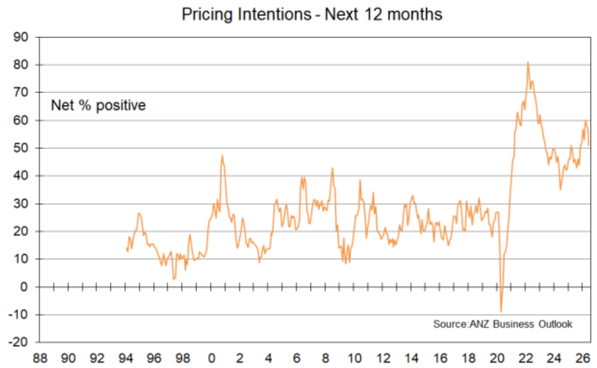
On top of this there is the risk I have been highlighting since the easing cycle of monetary policy started in August 2024. Business margins have been crunched and there is a risk that once the customers return in good numbers businesses will seek to rebuild their margins with extra increases in selling prices.

For the moment the pricing power of businesses in competitive sectors is quite restrained and that helps explain the so far limited evidence of widespread pass-through of higher fuel costs into selling prices.

In fact, my monthly survey of businesses with the people at Mint shows that for the moment more businesses plan cutting their prices or holding them steady than increasing them in the near future.



To track this particular risk I keep an eye on the selling price expectations measure in the ANZ's monthly Business Outlook survey. The latest update for this will appear this afternoon but the key thing is that the net proportion of businesses saying they plan raising their selling prices is running at about twice the average since 1994. This is relevant because since 1994 inflation has averaged 2.4%.



Nothing particular is suggesting a need for panic regarding inflation or interest rates. But the common belief that accelerating growth in our economy and eventually falling labour availability will be associated with inflation comfortably settling near 2% does not look right. Uncertainty this cycle is very high.

If I were a borrower, what would I do?

I've discussed interest rates above already this week so have nothing much to add here. If I were borrowing currently, I'd look to fix for a three year period in order to get over the 2027-28 period when I fear upside risk to borrowing costs.

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.