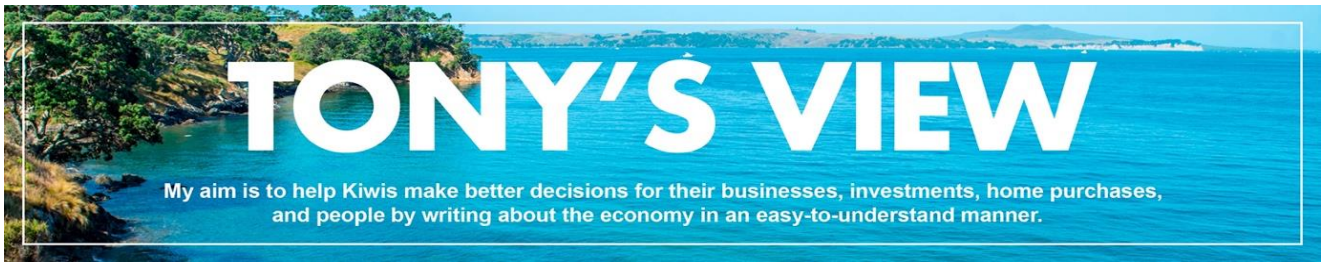

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ISSN: 2703-2825

4 December 2025

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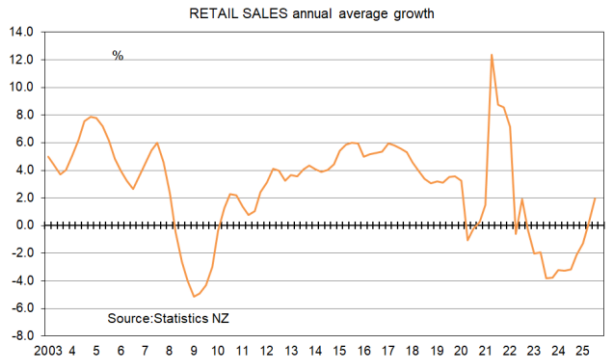
Retail spending jumps up – sort of

Commensurate with the data from my monthly Spending Plans Survey showing firmly rising plans to buy things since the April low-point, Statistics NZ this week have released data showing an unusually strong bounce in such spending.

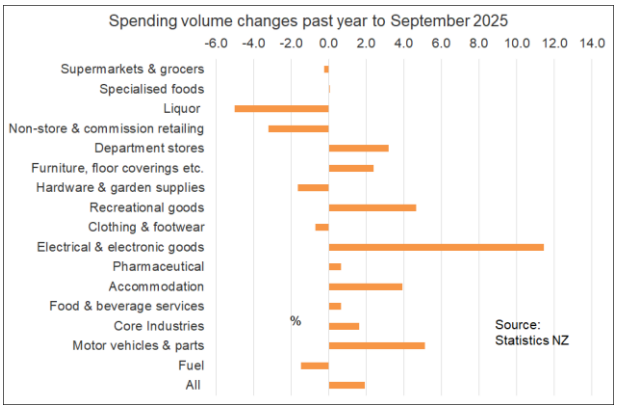
During the September quarter the seasonally adjusted volume of retail spending grew by a strong 1.9%, or by a still robust 1.2% if we exclude the often volatile petrol and automotive sales categories.

These rises followed changes of 1.0% and 0.7% respectively in the June quarter and tell us that consumers have been out undertaking spending this year – in some areas at least.

For the full year to September retail spending volumes grew by 1.9% which is acceptable but certainly not particularly fantastic. The main thing however is that we have moved away from the post-pandemic period of weakness which was aggravated by tight monetary policy and falling house prices.



Of course, not all stores have had an acceptable year. This graph shows spending volumes for each store type in the year to September compared with the year before. Note the strength for electrical goods, motor vehicles, recreational goods, and department stores, but weakness for liquor, and hardware & gardening.



Interpreting what these numbers really mean is hard at the best of times because of the vastly different offerings, locations, reputations etc. for individual stores. But things have been even harder recently because of the Covid disturbance up then down, rushes of new operators into some sectors then weeding out of many, a consumer move to shopping online, the continuing spread of large format type stores, customer desertion of CBDs as street people have moved in, and the divergent impact of monetary policy shocks.

The best interpretation of the Retail Trade data is probably that they show households are increasing their spending. Importantly, they reinforce the high risk that our central bank has again cut interest rates too far. The question then becomes one of trying to figure out their psychological bias this time around and whether they repeat their past mistake of leaving rates too low for too long.

Do the data suggest that easing monetary policy has had a boosting impact far sooner than my oft-mentioned timeframe of 18-24 months? True insight comes by looking at changes in consumer spending on durable goods. Such spending rose in volume terms by 5.4% in the September quarter after gaining 3.1% in the June quarter.

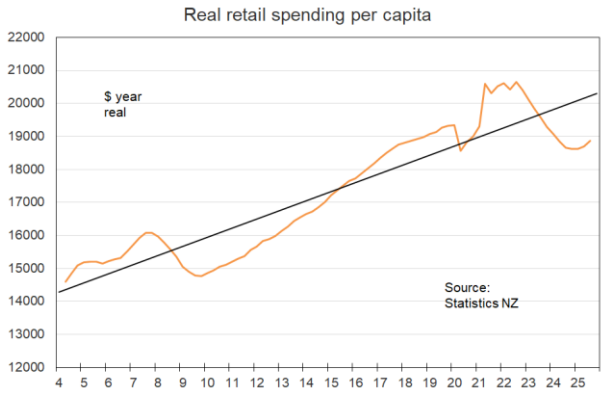
Therein lies the trap. All of the unexpectedly strong September quarter growth can be put down to the strong 10% rise in sales of electrical goods and 7% rise in motor vehicle sales. While one would normally interpret this as signalling a high spending drive overall underway from consumers the better interpretation is that this is a recovery after the slump following the pandemic binge I used to write so much about.

Think of it as akin to the cautions about "unusual tides and water movements" after an earthquake thousands of miles away.

We have not seen early appearance of the 18-24 month lag between cutting interest rates and the overall economy surging upwards to a good degree. That involves good growth in business investment and jobs, and we are not there yet. Thus, the 18-24 month period comment still stands – especially as you'd struggle to find many retailers saying things are great, that they're easily beating sales projections and are short of staff to handle the customer numbers.

Also, it pays to note that the jump in retail spending is coming off a low base. This graph shows the annual volume of retail spending per capita. Things are broadly where they were seven years ago. Hardly inspiring and perhaps best

illustrative of the challenges still facing many retail operators.



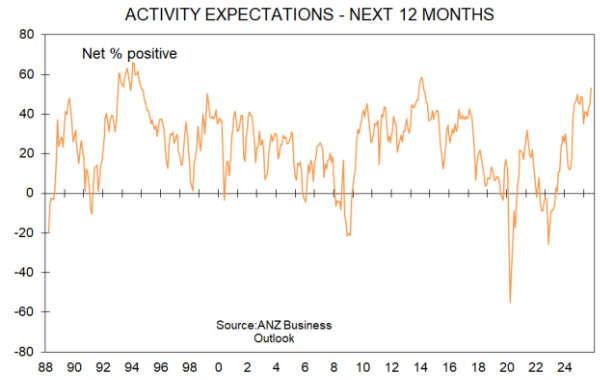
Nonetheless, the drift in the economy's direction is now upward.

Businesses didn't need the OCR cut

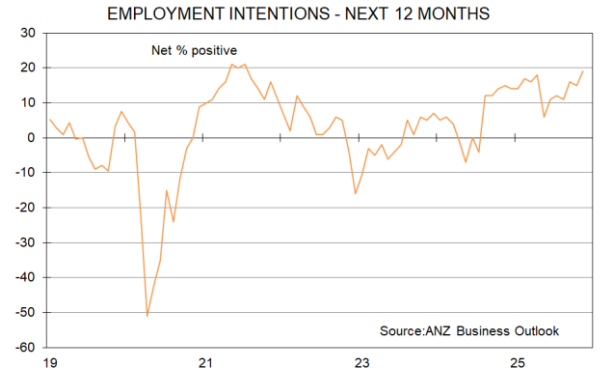
Just under a week ago and less than a day after the Reserve Bank cut interest rates again to stimulate the economy, we received data showing they did not need to. I'm not referring to the much stronger than expected retail spending jump in the September quarter discussed above but the results of the latest ANZ Business Outlook Survey undertaken early in November.

The net proportion of businesses expecting the economy to do well over the next 12 months jumped from 58% in October to an 11-year high of 67%.

The net proportion expecting their own activity levels to grow lifted to a net 53% from 45% - also an 11-year high.



The net proportion planning to hire more staff lifted to 19% from 15% and investment intentions eased a tad to 20% from 22%.

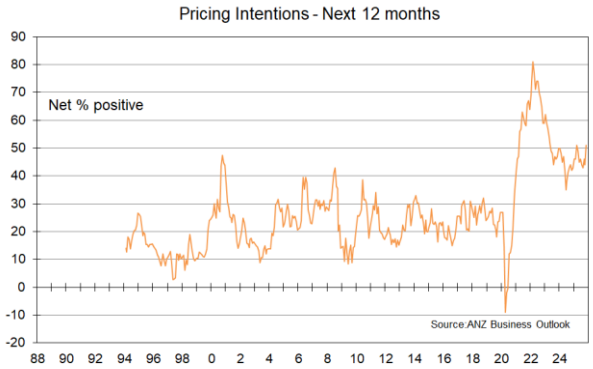


The data firmly tell us that economic recovery is underway and businesses plan backing their view with extra hiring and capital spending. But it pays to recall the concerns I have been expressing for

some time regarding the speed with which inflation will lift once businesses solidly see more customers coming through their doors and lift selling prices to rebuild margins.

Since 1992 inflation in New Zealand has averaged 2.3% and on average a net 26% of businesses in the ANZ survey have said that they plan raising their selling prices in the coming 12 months. That proportion peaked at 81% early in 2022, fell to 35% mid-2024 as the economy was shrinking 2%, then moved back up to 51% in April this year.

That is where the latest reading sits, up from the recent low of 43% in August.



To repeat – my concern is that after shrinking 1.1% in the year to June with job numbers falling 0.6% in the September quarter from a year earlier, inflation has only eased from the 7.3% peak of mid-2022 to the top of the 1% - 3% target range.

It is not highly probably that an acceleration in the pace of economic growth towards 3% and return of jobs growth will cause inflation to fall comfortably to 2% and sit there – especially not with wages growth still above average and business margins very tight.

As noted here many times, the risk for inflation is that it returns far earlier in the upturn than many are counting on and that the markets are currently pricing for. Hence my comment that if I were borrowing at the moment, I would fix five years below 5% rather than opt for the 0.5% cheaper one-year rate.

Note that if I am right about general inflation returning early in the upturn and interest rates also rising early, the extent of house price gains this cycle will again be contained.

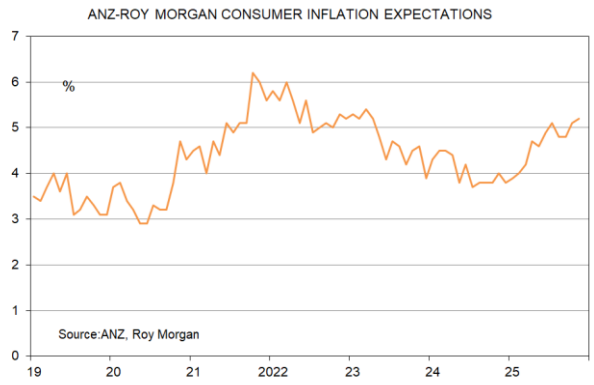
If I were a borrower, what would I do?

I would fix five years at 4.99%. Some might prefer three years at slightly less. Most people will fix one year near 4.49% because it is the cheapest rate on offer and they are not giving much thought to inflation and interest rate upside risks going forward.

To whit…

We learnt this week that rather than growing by a commonly estimated 0.6% during the September quarter the volume of retail spending actually jumped 1.9%. Additionally, we have learnt of a rise in business expectations for how busy they will be to an 11-year high while the net proportion of businesses planning to raise their prices is running at twice the average consistent with inflation near 2.3%.

On Friday the ANZ Roy Morgan Consumer Confidence index firmed to 98.4 from 92.4 and the average expectation for inflation in two years time rose to 5.2% from 5.1%. The following graph shows this expectations gauge, and the trend is firmly upward.



The economy did not need the 0.25% cut in the official cash rate undertaken by the Reserve Bank last week and probably also did not need the 0.5% reduction of October. The chances are high that the Reserve Bank has cut interest rates too far.

The question now is whether they continue past practice and leave them at overly low levels for too long. A change in Governor makes that a hard pick. The risk is they tighten earlier than previous occupants of the position would have opted for.

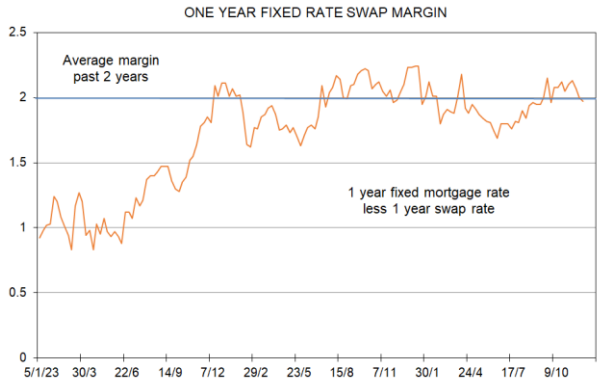
Before then borrowers should expect to see upward movement in fixed mortgage rates which could easily come before Christmas given the drift of things starting to appear in the financial markets now. In Australia expectations have shifted from more rate cuts to perhaps two rate rises late next year.

In fact, it pays to note that the cyclical lows for interest rates in NZ look like they were hit in about the middle of October. The one year swap rate back then was about 2.35% from 2.8% six weeks earlier. Now, around six weeks later the rate is near 2.52%. The three year swap rate mid-October bottomed out at 2.6% from 3% six weeks earlier and is now around 3.04%.

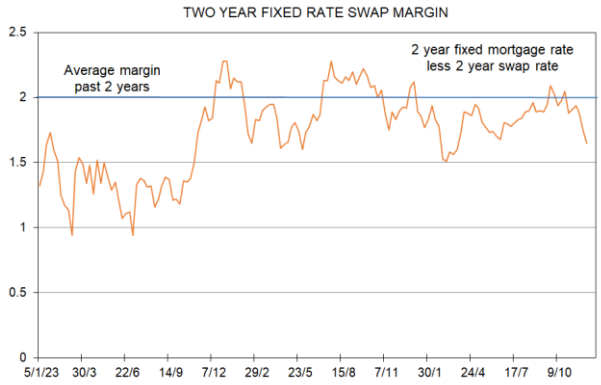
Or to look at it another way. All swap rates are higher than they were before the 0.5% cash rate cut on October 8.

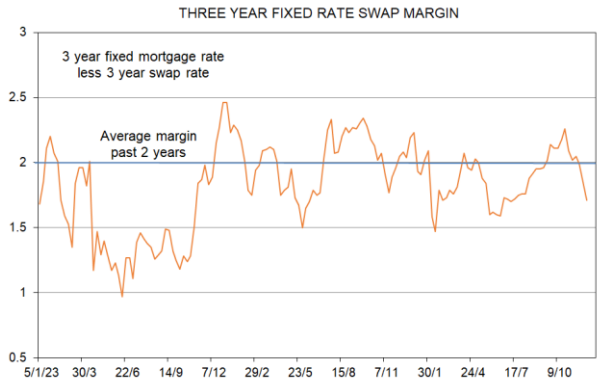
Is there as yet any serious pressure on banks to start raising their fixed mortgage rates? Here are the graphs I used to run showing roughly calculated margins on fixed rate lending taking into account only the wholesale swap rates and the best of big bank fixed mortgage rates. Pressure is developing for upward movements in fixed rates longer than one year.

The clock is ticking for this cycle's fixed mortgage rate lows. The graphs show that for the moment there is no obvious pressure for banks to raise their one year fixed mortgage rates.

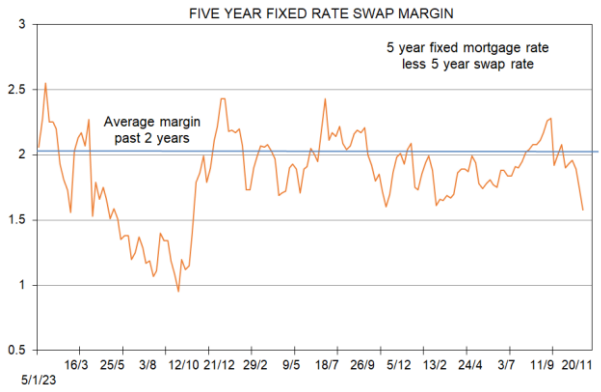


But for the two and three year terms pressure is definitely building.





Same for the five year. Soon it will be bye bye to 4.99%.



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.