# 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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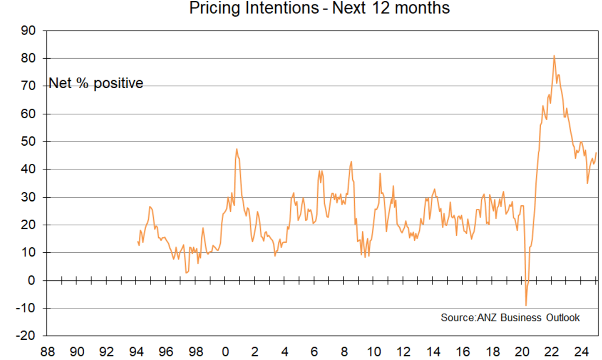
## Inflation stirs

One of my key themes and concerns is that inflation will not fall as far as people think and the cyclical recovery in inflation associated with the cyclical recovery in the economy will come sooner than many would like.

We have been able to see evidence of some of this underway in the price measures produced by ANZ in their monthly Business Outlook Survey. The latest edition released last week continues to show some worrying things.

Back in June last year a net 35% of businesses said that they expected to raise their selling prices in the coming year. This was well down from a peak near 81% in March 2022 and 49% in June 2023.

But since mid-2024 this measure has been creeping back up again and after reaching 42% in November went to 43% in December and is now 46%. This is well above the level consistent with inflation averaging 2.3% since 1992 of 26%.




Businesses are strongly stating that they plan to raise their selling prices, and a key reason is that their costs are still rising sharply. A net 74% in January – up from 70% in December – said that they expect their costs to go up.

In addition, the average inflation rate expected in a year's time by the ANZ survey respondents rose to 2.67% in January from 2.63% in December and 2.53% in November.

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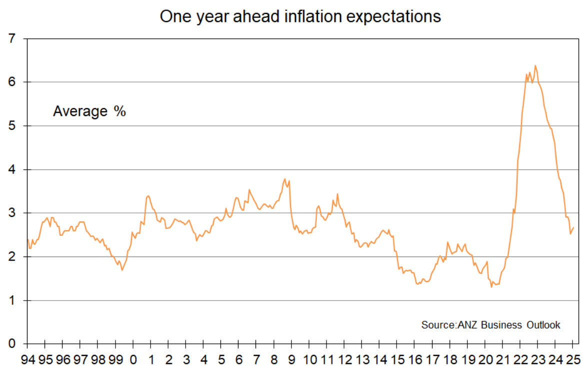
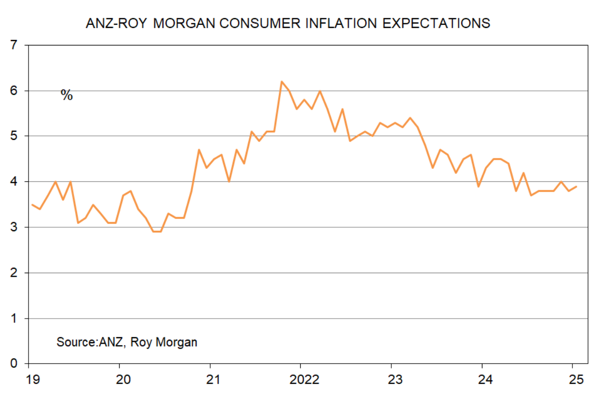



These movements are in the wrong direction and not only are these measures above levels consistent with low inflation they are rising before the widely expected increase in household spending has even started.

Once consumer demand picks up it is reasonable to expect that these measures will rise further and that is why we need to start thinking in terms of the official cash rate not falling much further than the current 4.25%, and that it may start to go back up again in 2026.

Already in the United States there is talk of monetary policy tightening rather than easing much more. The markets are not pricing this in yet but if they do then this will immediately feed through to higher medium to long term borrowing costs in New Zealand.

We received a hint that Kiwi consumers may be getting less optimistic about the future for inflation from the ANZ Roy Morgan monthly consumer confidence survey. While showing a small decline in confidence it revealed a rise in the average year ahead inflation expectation to 3.9% from 3.8% in December.

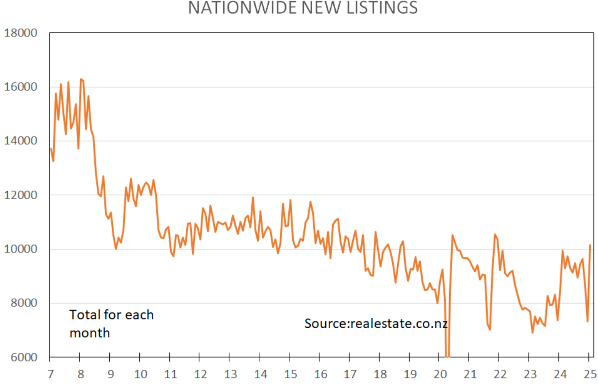
It's a fairly small rise but the important thing is that this measure stopped falling in about June.

The time period during which Kiwi borrowers will be able to lock in a 3-5 year fixed mortgage interest rate near lows for the cycle may be a lot closer than people have been thinking. As previously noted here. I anticipate making a fictional personal decision to fix 3-5 years rather than continue to fix short before the middle of this year. (Actually, with one bank newly offering 4.99% for three years I would take that rate today.)

## Are property listings surging?

During the week you may have noticed headlines regarding a very large surge in the number of properties freshly placed on the market for sale in January. In seasonally adjusted terms the numbers rose 39% from December to 10,200 from 7,300.

But before one concludes that the market is about to collapse as everyone seeks the exit door it pays to noted that in seasonally adjusted terms the number of new listings fell by 15% in December after falling 10% in November.



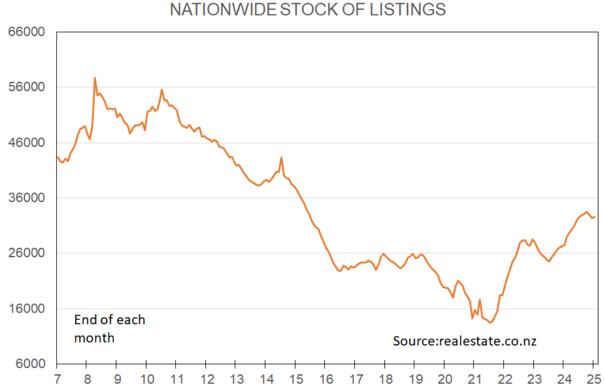

I'm thinking either the seasonal adjustment model used by realestate.co.nz needs improving, or we simply had people holding back in December then stepping forward in January. If we add new listings for the three months to January together, we get a fall of almost 7% from the three month sum ending in October.

So, no, there is not a flood of new listings hitting the market – just some very high month to month volatility.

A better feel is gained by either looking at the graph above showing each month's fresh listings, or focussing on the end of month total stock of listings.

At the end of January this listings stock stood at 32,700 which was a small rise from 32,400 at the end of December and a decline from 33,500 at the end of October.

This graph sums it all up. Listings rose strongly from the middle of 2021 as sales fell away. They went down for a while in 2023 as young buyers hit the market to take advantage of good listings, low prices, and low competition. They then rose through 2024 as the economy and people's feelings about it tanked anew under strong cost of living pressure.




But now, with hopes for better growth this year and next (do not order drinks to celebrate) there is a small downward trend in listings stocks. Let's be conservative and call it a flattening out.

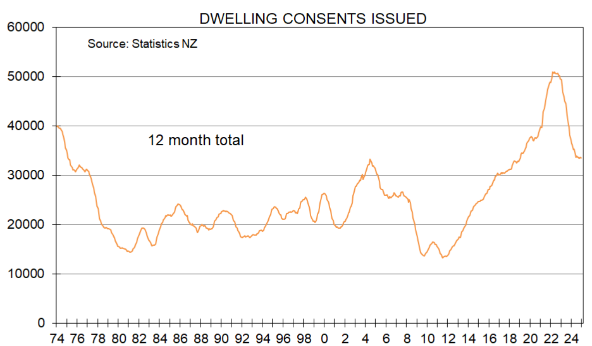
## House construction flat

We perhaps should also talk in terms of a flattening out with regard to the number of consents being issued for the construction of new dwellings around the country. In seasonally adjusted terms consents fell 5.6% in December

after rising 4.8% in November and falling 5% in October. They go up a bit then they go down a bit.

But for the December quarter overall numbers fell by 4.1% after rising 7.6% in the September quarter. It looks directionless.

The annual number of consents has held near 33,600 since June.

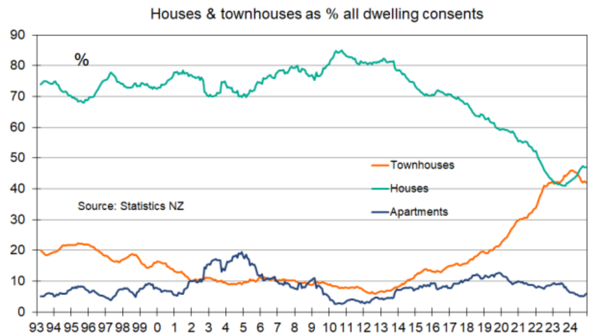



If this is the bottoming in the cycle, then it is at quite a high level compared with the past half a century. That is a factor which will help suppress the pace of house price increases and helps account for the flatness in prices at the moment.

Underlying everything however there is a recognised oversupply of townhouses in Auckland and probably Christchurch CBD as well. This suggests that for townhouses lower construction likely lies ahead. The annual number of townhouse consents was 15,200 in June and was 14,100 come December. The trend does look down.

For houses it was looking like an upturn may be underway. Can we still reasonably think that? In seasonally adjusted terms over the December quarter standalone house consents were down 13% after rising 11.4% in the September quarter – which is where some of our excitement came from.

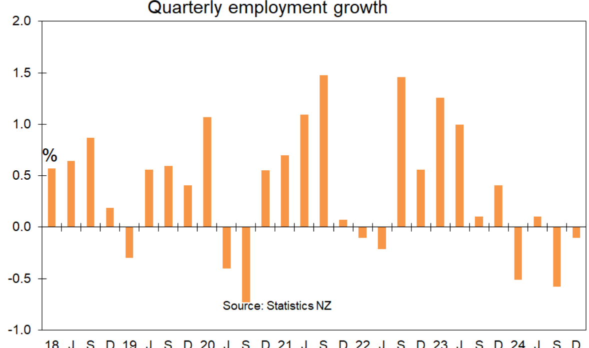
The annual number of house consents has risen from 14,900 in June to 15,800 in December. So, I'll stick with a view that house consents are slowly edging up but that townhouses face a lot more downside risk.




## Unemployment rises as expected

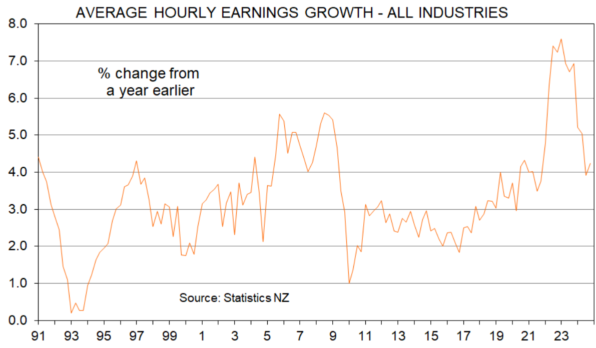
Yesterday Statistics NZ released the quarterly labour market data. They told us that during the December quarter the seasonally adjusted unemployment rate rose to 5.1% from 4.8% in the September quarter and a multi-year low of just 3.2% in the September quarter of 2021 when the economy was over-stimulated by loose fiscal and monetary policies.

The rise in the unemployment rate to 5.1% was expected in the markets hence no interest rates reaction of note. It reflects the weakness in New Zealand's economy last year which produced a fall in employment of 0.1% in the December quarter from -0.6% in the September quarter.




Of immediate relevance to the Reserve Bank's interest rate decision in a couple of weeks are the wage growth numbers. Ordinary time average hourly earnings rose by 1.4% in the December quarter after rising 1.1% in the same quarter a year ago, 0.9% two years ago, 1.0% three years ago, and 0.8% four years ago.

Wages growth has just accelerated by this measure with the annual change rising to 4.2% from 3.9% in the September quarter. But the rate a year ago was 6.9%.




Progress has been made on wages growth slowing but maybe that progress has stalled. Yet with productivity falling this situation does not add up. Either some of the data are wrong or we have a situation in New Zealand where people are being paid more for doing less – yet the remuneration is poor compared with what most people can earn in Australia.

The implications for inflation are bad but are mitigated somewhat by an alternative wage growth measure called the Labour Cost Index rising 0.9% in the December quarter from 1.5% a year ago and 1.4% two years earlier.

The data collectively do not lead to a conclusion that inflation pressures coming from the labour market have collapsed and a lot more easing of monetary policy is made possible. The best interpretation is that the door is still left open for a greater lagged response of the labour market to economic weakness. But the risk is that the lack of true weakness and woe in the labour market means the early onset of a cyclical lift in inflation as the economy grows remains quite live.

## If I were a borrower, what would I do?

One of the main banks has just announced a three year fixed rate of 4.99%. If I were borrowing at the moment I would take it.

Now for what I wrote the day before…

We are living through very uncertain times and that means risk taking is a risky thing to do. In the context of interest rate risk management this means floating or fixing for one year or less is riskier than normal. That is because the ability of the markets and us economists to reasonably accurately predict where interest rates will be in a year's time is less than normal.

For that reason borrowers should give increased thought compared to normal to fixing long as a means of buying time to adjust to rate shocks rather than minimising rate cost.

Where do the enhanced risks of these times come from? Many places. One is the nascent attempt of our coalition government to place New Zealand back on a path of growth. There is little chance that the policies announced so far will have meaningful impact and I doubt any young person contemplating going to Australia is having second thoughts because there may be more work available serving coffee to foreign visitors.

I doubt the thought of foreigners occupying our rental accommodation while being paid offshore as digital nomads is an incentive to stay and compete with them for that accommodation. And I doubt a new national debate about selling some of the few assets left will make people feel our future looks bright – whatever sales do and do not occur.

Our economic growth outlook and therefore our inflation outlook is very uncertain.

Another risk source and perhaps the biggest of all is the trade war which may erupt because of the adoption of tariffs as a means of international influence and domestic production protection by President Trump. US inflation will be boosted but we don't know by how much and we don't know how this will impact US interest rates.

Other countries will respond to higher US tariffs. But we don't know how much and what the impact will be on world growth and inflation. We do know that the outcome will be reduced world productivity and income per capita growth.

Then there is the uncertainty associated with the inflation dynamics in New Zealand. The relationship between any given unemployment rate and inflation is now different from the past. But how different? Underlying growth in productivity and therefore the ability of our economy to grow without inflation being a problem has deteriorated. But by how much?

And what lessons if any has our Reserve Bank learned from its poor monetary policy decisions during the pandemic period? The arrogance endemic to the institution suggests they will have learnt nothing. After all, their admission post-GFC that they made mistakes in not tightening monetary policy fast enough pre-GFC seems not to have removed their blindspots during the next crisis.

Then again, given that no-one on the planet had experience of what usually happens when a global pandemic occurs, we cannot lay blame for the inflation outcomes solely at the door of our struggling central bank.

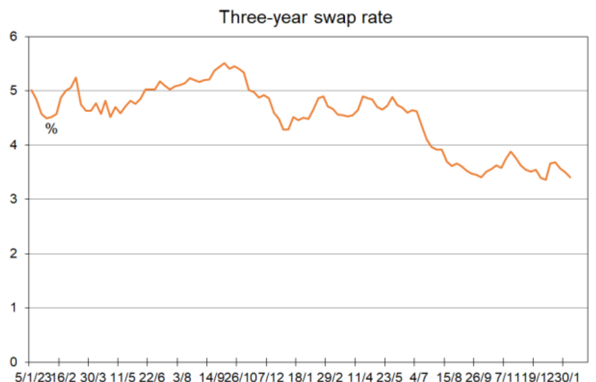
The key point I am attempting to get across is this. I do not expect, and I do not believe any other economist here expects, to accurately pick the low-point for interest rates in New Zealand ahead of time. We will only know it when looking back.

For me this means greater favour should be shown to fixing a portion of one's loan at a medium to long-term fixed rate than would normally be the case.

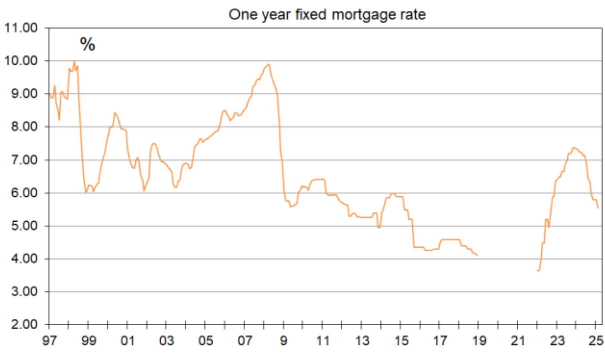
When I couple that risk-derived view with my other view that the cyclical rise in inflation is going to arrive sooner than people expect I get my view that the time to fix three years or longer will probably arrive before the middle of this year.

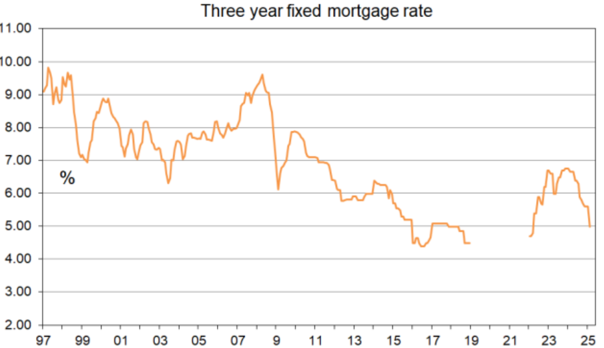
As it turns out, one bank has just announced a three year fixed rate of 4.99%. I would take it.

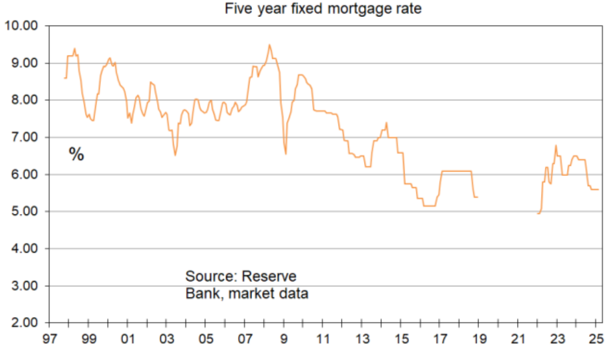
This week wholesale bank borrowing costs have edged lower with the three year swap rate they pay now sitting near 3.41% from 3.5% last week and 3.7% a month ago. But this rate started the year lower near 3.3% so the latest move is not all that significant.



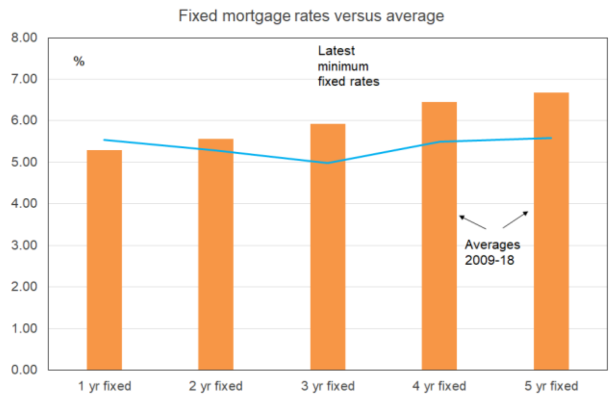

These three graphs show levels of the one, three, and five year fixed mortgage rates over the past few years excluding the 2019-21 period when rates were absurdly low because of worries about deflation and then the effects of the pandemic.




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



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

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