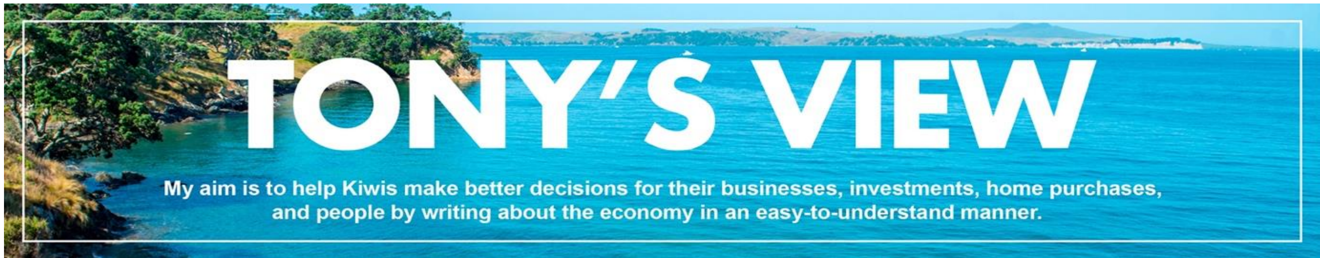

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ISSN: 2703-2825 7 November 2024
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Jobs market eases

While the political highlight this week has been the US Presidential election the short-term economic focus here was on yesterday's labour market data released by Statistics NZ. The key thing to note about the jobs market is that it reacts with a lag to changes in the economy.

When times get tough for businesses, they don't immediately start shedding workers just in case things get better. But as the weakness grinds on they realise people need to be let go initially because activity levels are down, and they are not needed.

But then after a while as cash flows probably remain tight businesses need to undertake restructuring as opposed to rightsizing. That is probably about where we are now and is part of what I have long called "weeding out".

The data released yesterday show the unemployment rate rising to a slightly lower than expected 4.8% from 4.6% in the June quarter and the unsustainable low of 3.2% seen in the middle of 2022 when the economy had been over-stimulated by the Labour government and Reserve Bank.

Why was the rise in the unemployment rate so small when seasonally adjusted job numbers fell 0.5% in the September quarter. That is a reasonably large decline. The reason is that a lot of people left the workforce. Some may have been discouraged by the lack of job opportunities. Others may have decided the cost of childcare was too high in comparison with their potentially precarious employment situation.

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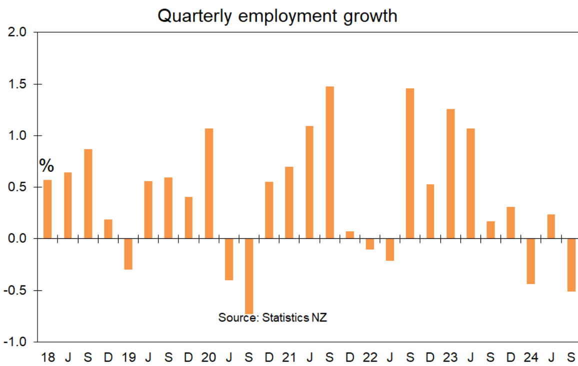
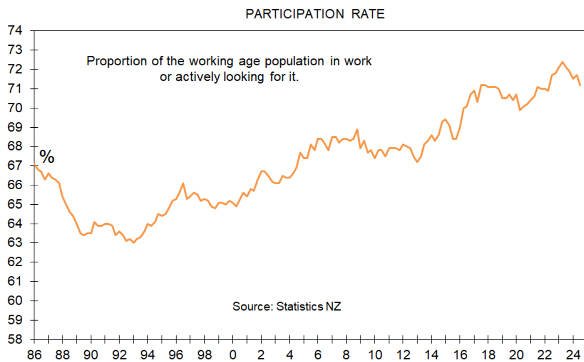


The participation rate which measures the proportion of the working age population either in work or actively looking for a job fell to 71.2% from 71.7% in the June quarter and a peak of 72.4% in the June quarter of 2023.



This rate is likely to decline further and that will limit the extent of the extra rise in the unemployment rate which is highly likely to occur over the next few quarters as employers continue to adjust their businesses and the economy perhaps does not turn out to be quite as blindingly rosy as business surveys say operators expect.

Of interest from a monetary policy view is not just the easing up of the labour market but the extent to which this is manifesting itself in a slowing of the pace of wages growth. The annual change in average ordinary time hourly earnings gleaned from the Quarterly Employment Survey data has fallen to a near three year low of 3.9% from 5% last quarter and a peak of 7.6% at the start of 2023. Wages growth is slowing down.

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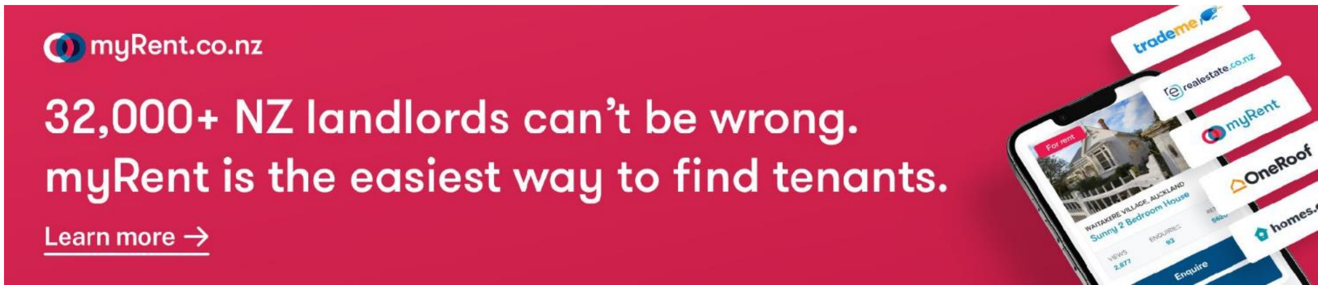
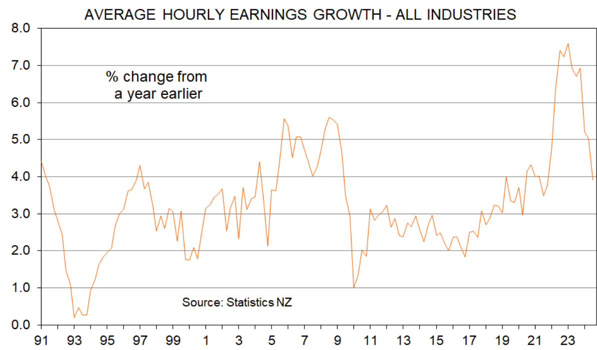
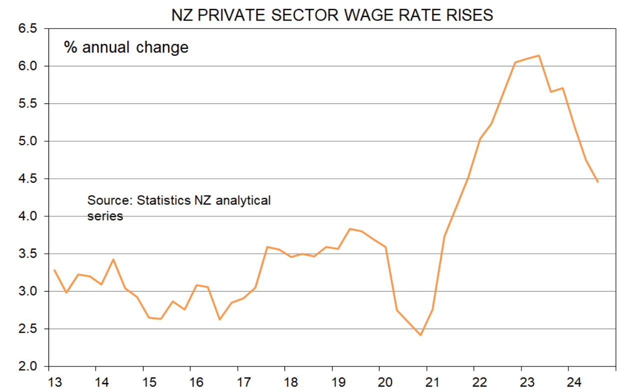




The 1.2% increase in the private sector wages measure for the September quarter is at the bottom of the usual increase for this quarter so it is likely that the Reserve Bank will feel things are tracking as they would like for the pace of wages growth.

However, the Labour Cost Index which attempts to remove distortions from changes in the industries people work in rose by 0.9% in the quarter and 4.9% from a year ago. This is a tad too high still. The graph here shows this measure for just the private sector.

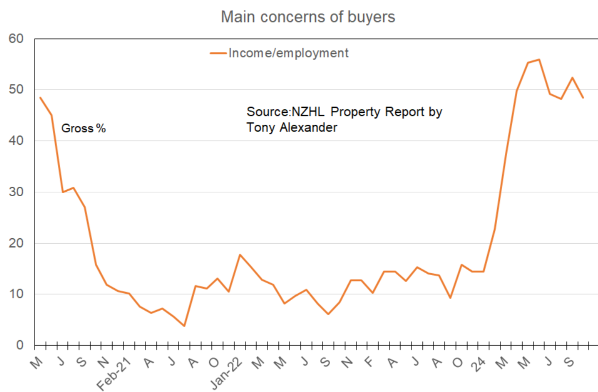


The upshot is that the data released yesterday do not stand in the way of a further easing in the official cash rate of 0.5% come November 27. The chat about a 0.75% reduction has well quietened down recently in the face of rises in US bond yields and scaling back of US policy easing expectations because of good data on the US economy.

The inability of state and Federal governments in Australia to rein in their spending is also keeping rates across the ditch elevated and their first policy easing may not happen until well into 2025. An easing before the May deadline for a Federal election is not certain.

For your guide, results from my monthly survey of real estate agents with NZHL show job insecurity remains high. I ask agents to note the things which buyers are concerned about, and they can tick boxes for things like listings availability, interest rates, access to finance etc. and employment.

On average since I started the survey in the middle of 2020 20% of agents have said that buyers are worried about their jobs. In January this reading was only 14%. It peaked recently at 56% in June and now sits at a still high 48%.



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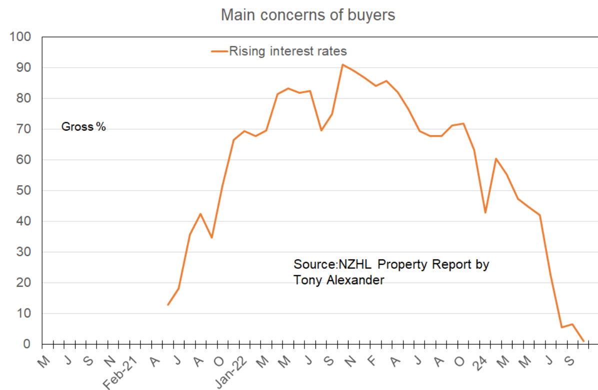
Contrast this with the collapse in worries about interest rates.



These developments illustrate the way in which for residential real estate interest rates matter more than employment given the strong lift in buyer interest in the market since the middle of the year.

If I were a borrower, what would I do?

The key message which I have been attempting to get across in my interest rate commentary over recent weeks has been this. Despite downside risks to the likely pace of our economy's growth over 2025 into 2026 the risk is interest rates do not fall as far as people have been expecting.

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Up until recently many people were talking about a 0.75% rate cut for November 27 and the official cash rate falling as low as the GFC level of 2.5%. Such talk has notably quietened down over the past three weeks and the situation is gravitating to the next cut being 0.5% (the average size of a cut since 1999 has been 0.46%), and the cash rate bottoming out between 3% and 3.5%.

Reasons for caution over interest rates optimism include the still high pricing intentions measure contained in the ANZ Business Outlook Survey, the well above average cost increase expectations revealed by businesses in the NZIER's Quarterly Survey of Business Opinion and a few other things.

First, the unemployment rate has increased from 4.6% to 4.8% which is below the 5% level predicted by the Reserve Bank. That suggests slightly less downward pressure on the inflation rate from the easing labour market. The difference is fairly small, however.

Second, the housing market is showing some good momentum upward with investors now joining first home buyers in greater numbers. There are upside risks to house prices but again this effect will probably be fairly small in terms of

adding slightly to inflation because of the surge in supply also coming forward.

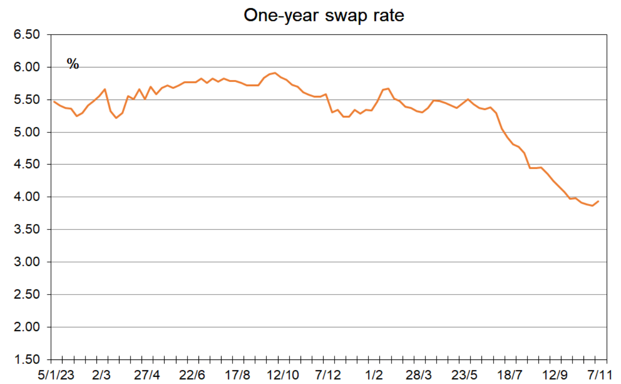
Third, in Australia profligate public spending is adding to inflationary pressures and limiting the timing of their first rate cut from 4.35%. The relevance for ourselves is higher prices for goods imported from Australia and some downside risk for the NZD/AUD exchange rate. Again, the effect will be fairly small.

Which brings us to the fourth element now in play – the re-election of Mr Trump as US President. His policy of raising tariffs 10% - 20% for all countries and 60% for China will boost US inflation. This means less scope for lower interest rates there and already the ten-year US Treasury yield has risen by almost 0.75% over the past seven weeks. The yield has risen about 0.14% overnight upon confirmation of the US election outcome.

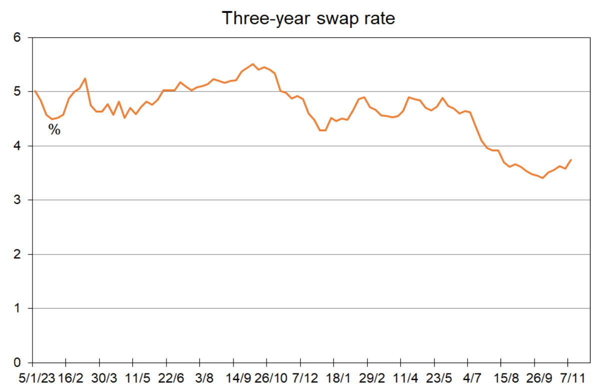
There will also be upward pressure on US inflation from the deportation of many immigrants and tax cuts. A risk is that other countries also raise tariffs but there is an offset from the risk that China dumps product no longer able to be profitably sent to America into other countries.

I have repeatedly used the word "risk" here because there is considerable uncertainty about how strong the extra pressure on inflation offshore and here will be as a result of the US election. Suffice to say I feel more secure with my warning that the extent of interest rate declines in NZ this cycle will likely be less than many people are thinking. As to timing – history tells us that we forecasters will continue to make many changes in our predicted rates track as we advance through 2025. I'd watch for talk of rate cuts bottoming out early becoming dominant at some point next year.

This week the one year swap rate at which banks borrow to lend at a fixed rate for one year has moved up to 3.94% from 3.87% last week. This is about where the rate was five weeks ago.

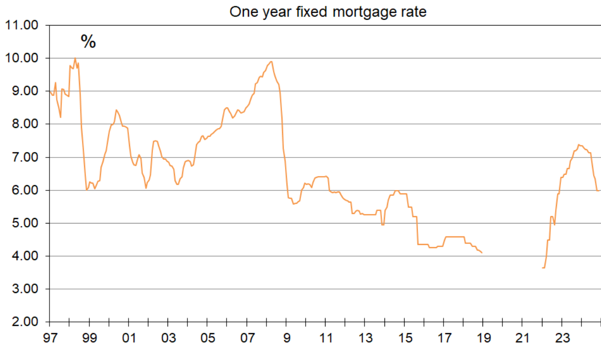


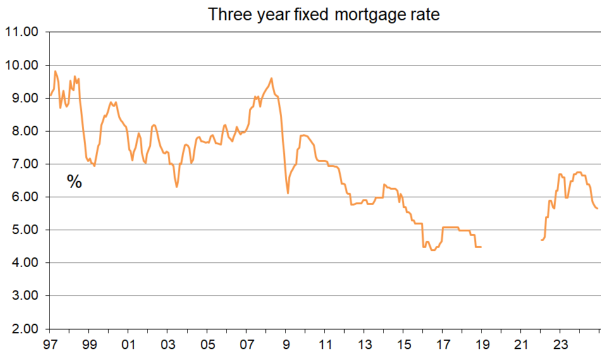
However, when we shift further out along the yield curve, we see the three year swap rate has risen to near 3.74% from 3.58% last week and 3.41% five weeks ago. The five year rate is about 0.4% ahead of five weeks back.

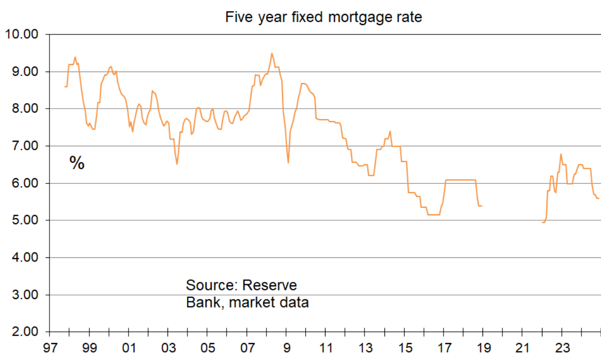


Might these rises lead banks to raise some of their fixed mortgage rates? That is always possible. But the margins still look quite healthy, so my pick is they won't initiate increases. After all, we should expect some volatility in financial asset prices for the next few weeks as we try to figure out the true impact of a new Trump Presidency.

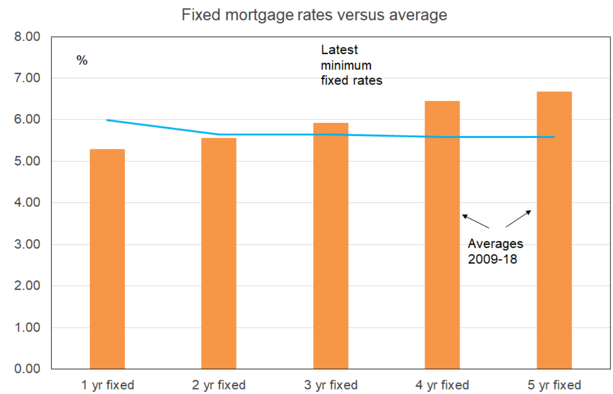
These three graphs show levels of the one, three, and five year fixed mortgage rates over the past few years excluding the 2019-21 period when rates were absurdly low because of worries about deflation and then the effects of the pandemic.







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



If I were borrowing at the moment, I would be happy to fix for just six months in anticipation of switching to a longer rate at some point from mid-2025 onwards.

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

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