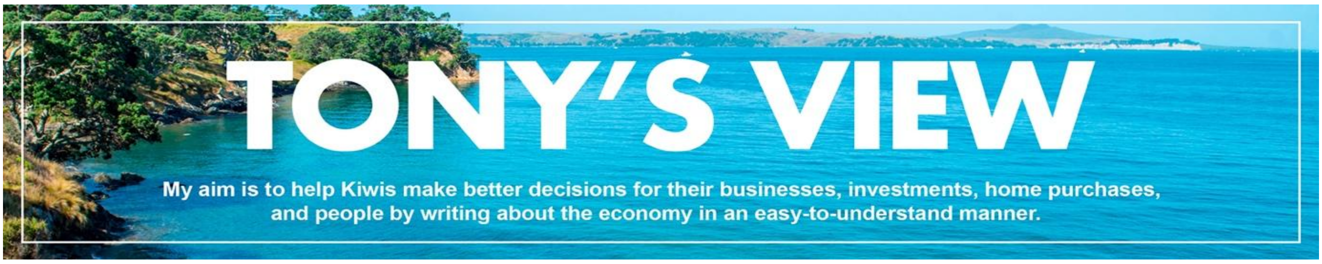

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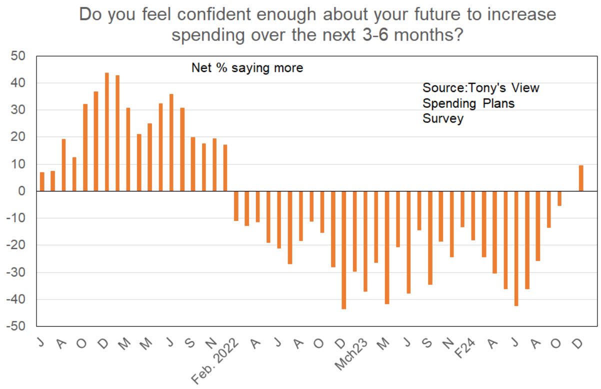
Consumers to spend more

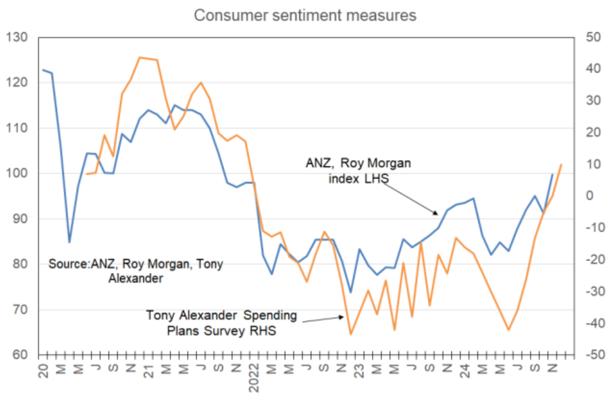
My central themes are that an economic upturn is getting started but it will be muted and won't prevent some more businesses closing down over the first part of 2025 as cash flows will still be too poor to get them through to the stronger customer flow environment. Also, interest rates will ease but the bulk of declines in rates for two years and beyond have already happened and the extent of growth stimulus will be less than many people are expecting.

In a modern economy like ours some 65% or so of spending is undertaken by households and that is why it is useful to pay attention to leading indicators of what you and I as consumers look likely to do with our money. This week I have in hand the results from my final Spending Plans Survey for 2024 and they show that these plans for spending over the next 3-6 months are the strongest in exactly three years.

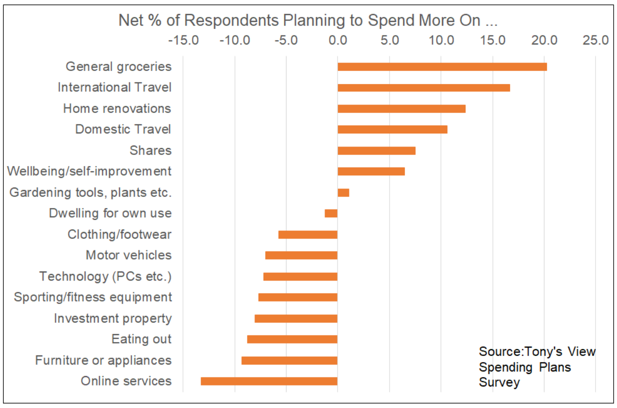
A net 10% of the 558 respondents have reported that they intend raising their spending levels on stuff generally.



This survey tends to lead or coincide with the long-running ANZ Roy Morgan Consumer Confidence gauge. That means we can reasonably expect some more strength to show through there fairly soon and that this will add to the cautionary feeling in financial markets regarding the extent to which the Reserve Bank will feel extra stimulus (less restraint actually) needs to be applied to the economy once the cash rate reaches 3.5%.

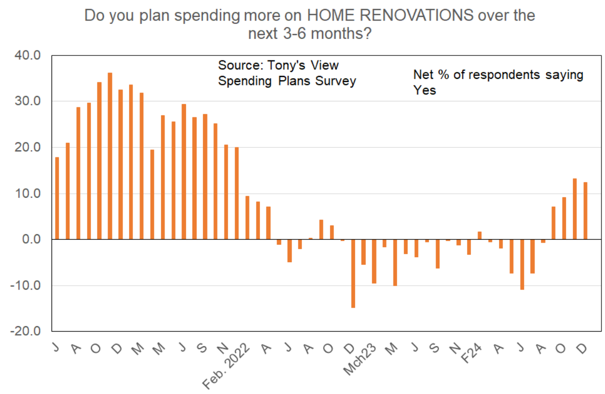


People are planning to boost their spending in seven of the offered categories with greatest strength in groceries where the factor in play is probably still the impact of well remembered price rises. International travel is back in favour and the lift in plans for home renovations is confirmed.

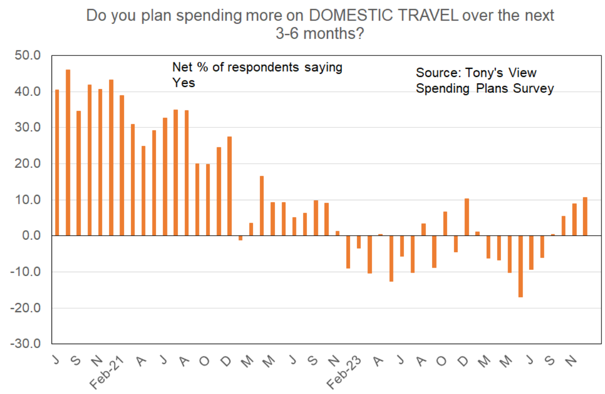


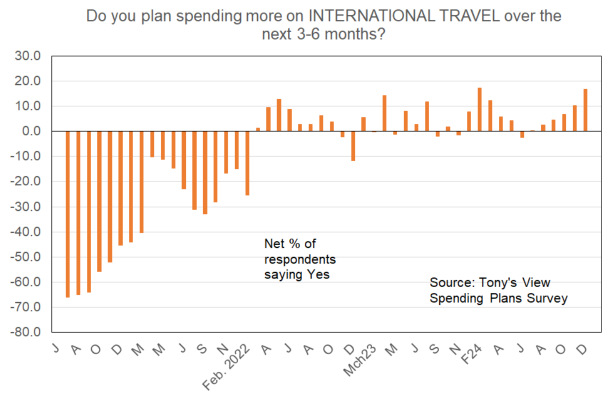
Here are graphs for some of the categories listed above.

As mentioned above and noted also recently in a newspaper article, those involved in the home renovations sector are experiencing a solid upturn.

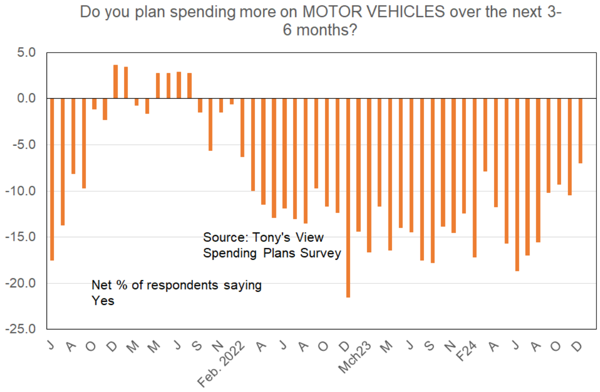


Domestic travel plans are firming while those for offshore travel are as strong as they have ever been in the past for the period covered by this survey since mid-2020.

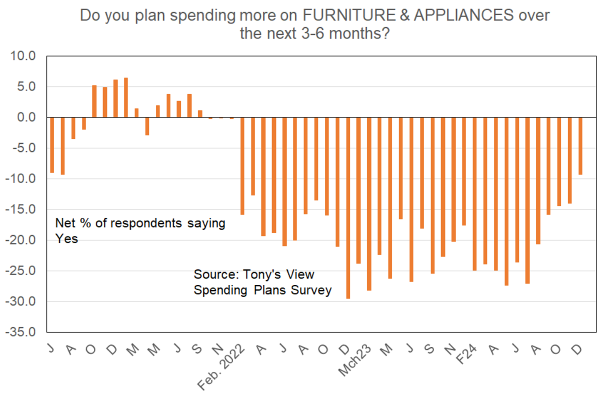




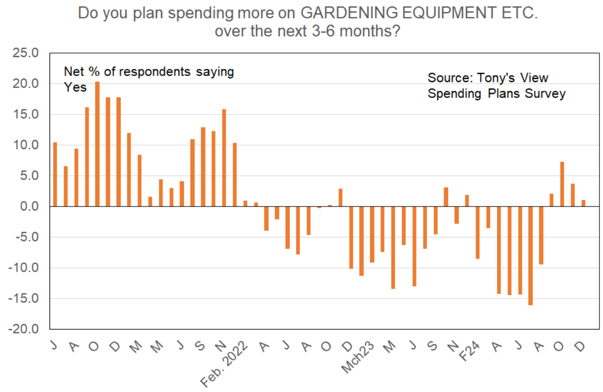
It is interesting that the solidity and implication of seriousness about the spending improvement signalled by the lift in renovations plans is not yet being seen in a net positive result for motor vehicle purchasing. The sector is one in a state of flux with reduced interest in fully electric vehicles, increased interest in hybrids, and perhaps awareness of a wave of the former coming out of China.



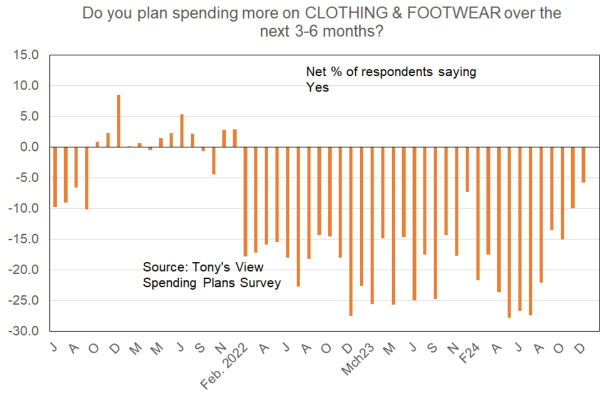
Plans for spending on furniture and appliances are also still firmly net negative. This suggests that some tentativeness about spending plans by Kiwi households remains amidst cost of living pressures and rising unemployment.



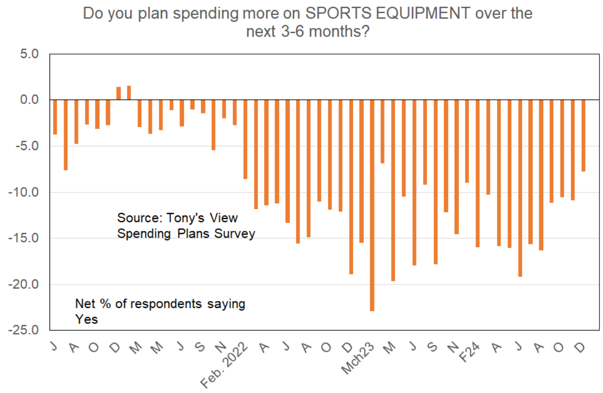
The gardening upturn has remained muted.



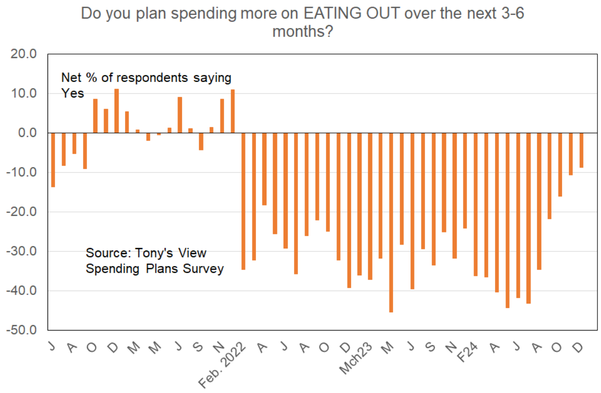
Prospects for clothing and footwear retailers are better but still poor overall.



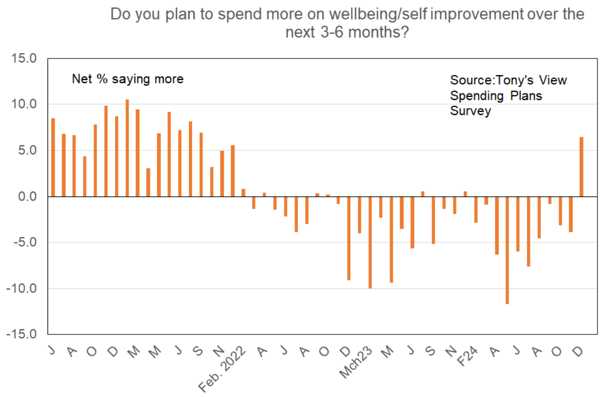
Same for sports equipment.



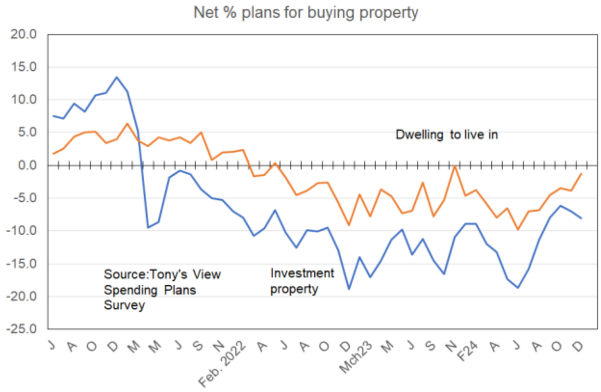
For the area of spending which had the worst level of spending plans in the past things are close to being net positive – but not yet. What my survey hasn't been able to capture is the lift in eating out which involves takeaways as opposed to going to a restaurant or café.



I'm not sure what to make of the firm jump in people's plans for spending on their wellbeing. But it seems reasonable to assume that the outlook is getting better for those providing such services.

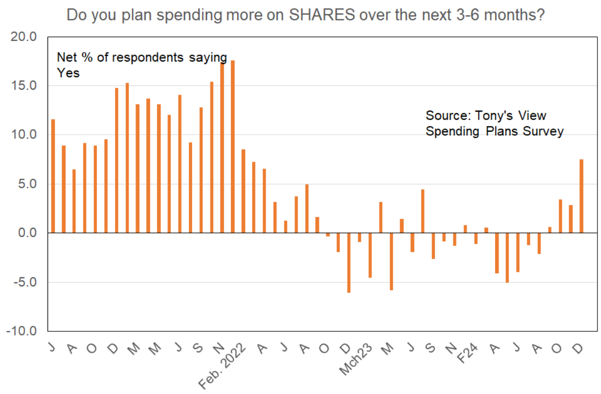


Backing up the data from my other surveys showing an improving trend in residential real estate but no frenzy, only a net 1.3% of people now plan cutting spending on a place to live in. This is the least negative such result since May 2022.

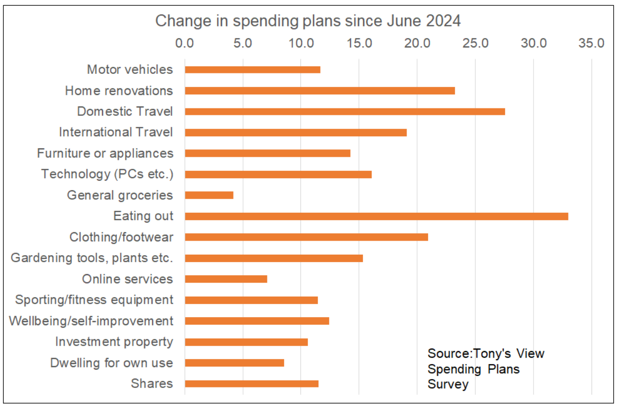


Net plans for purchasing an investment property (the blue line above) however are not showing a continuation of the improving trend which emerged mid-year.

Finally, when it comes to shares people are getting a tad excited.



Next week I will take a look at the developments in factors which people cite as driving their decisions to spend more or spend less. But to finish with here is a graph showing the extent of improvement for each category I track since the depths of despair in June this year.



This all largely sounds positive. But is consumer spending going to truly surge? Probably not.

- Some things which people might normally be thinking about buying in the coming year as conditions improve, they have in fact already bought during the pandemic binge.
- Business failures in the extended "weeding out" period alongside right-sizing by many others will see employment confidence sit on the low side for employees all through 2025.
- At some stage general discussion about interest rates will shift from great optimism associated with them falling to "is that it?"
- Discussions of capital gains taxes, wealth taxes, new levies, fiscal deficits and the old saw of superannuation unaffordability etc. will make people wary of spending at the margin and encourage emigration.
- Councils are promising much higher rates, costs related to climate change are growing, and electricity companies are promising more price rises. Anticipation of ongoing cost of living pressure will in particular restrain the willingness to spend of older people.
- House price gains this cycle are likely to be restrained. That means a smaller than usual positive wealth effect on consumer spending for the next three years.

If you are a retailer or a supplier of goods and services to retailers you can justifiably expect better conditions over 2025-26. However, the strength of rebound in consumer spending is unlikely to be so large that the other sector-specific challenges you face (new competitors, ways of shopping etc.) will be smoothed over. Your need to adapt will remain strong.

If I were a borrower, what would I do?

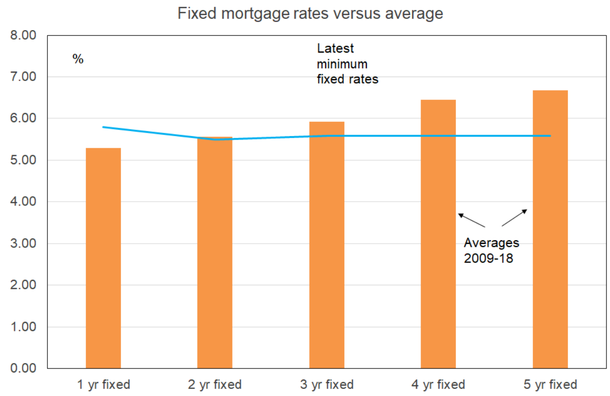
My answer = start thinking about this little sentence. “Is that it?”

I see quite a high risk that people expect mortgage rates to fall a lot further from current levels than they have so far. With the official cash rate so far down by 1.25% and likely to fall another 0.75% we have seen one year fixed mortgage rates decline about 1.5%, three year rates about 1.4%, and five year rates about 1.0%.

From current levels I see scope for maybe another 0.5% coming off the one year rate and less than that for rates two years and longer. That means the one-year rate may optimistically bottom out just above 5% from near 5.8% commonly at the moment. The three year rate may fall from near 5.6% towards 5.2%, the five year rate from near 5.6% also to just over 5.2%.

But as noted, this looks like the optimistic scenario from a borrower’s point of view. In fact, it pays to note that over 2017-18 when the official cash rate averaged 1.75% the one year rate averaged 4.4%, the three year rate 4.9%, and the five year mortgage rate 6%.

Note the graph I include in TV each week below showing how the current fixed rates represented by the blue line compare with averages for each over the post-GFC period before the worries about deflation and pandemic. We are already below average for terms of three years and beyond. Here it is for the scrollingly challenged.



The question of course is to what extent will the Reserve Bank feel that monetary policy needs to be quite accommodative (very low rates) in order to ensure inflation does not look like settling towards the low end of the 1% - 3% target range. My view is that they won’t feel much need to pump the accelerator at all. Taking the foot off the brake will probably be enough this time around.

As noted, there are boosts to inflation to come from increases in council rates, electricity, climate change-related things, and the environment of rising house prices (calm, not frenzied). Rising dairy prices (great for the NZ economy) will mean higher prices for cheese etc.

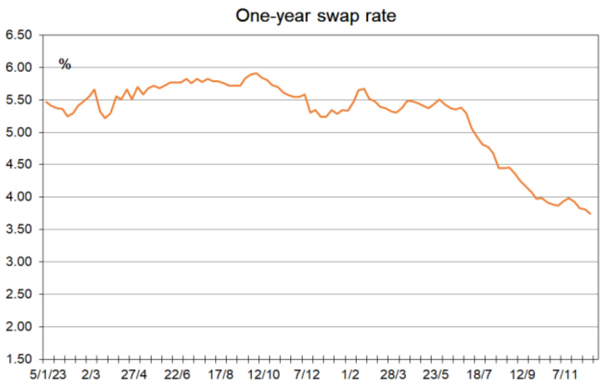
Add in the structural decline in New Zealand’s underlying rate of productivity growth. Then consider the factor I have been harping on about for the second half of the year here. Business margins are crunched, and survey results suggest that once customer demand improves, they are going to recoup crunched margins by raising prices.

Note that I am not taking a position on global inflation. I do not know how things are going to change there. A higher global inflation scenario on the basis of the return of tariffs and decline in multilateralism seems a reasonable assumption. But a lower environment seems reasonable if one focuses on deflation in China and their diversion of exports from the US to other markets such as our tiny one.

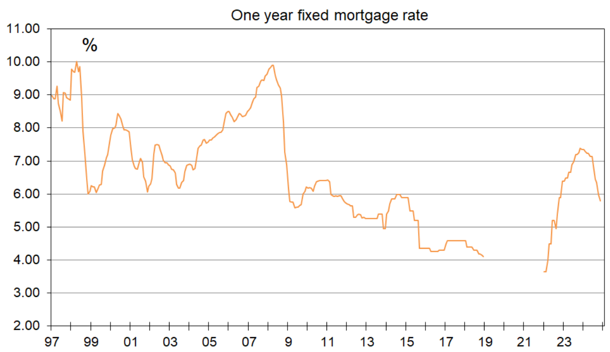
What all of this adds up to is something quite simple from a borrower’s point of view. Run your numbers assuming an interest rate of 5.25% for the next three years. As for when the time will be optimal to switch from fixing six months to three-plus years – I don't really have a view and can only see myself jumping up and down again to suggest fixing long if one lender decides to radically discount a long rate sometime next year.

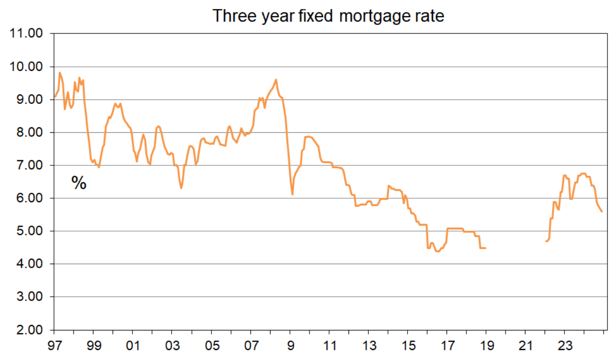
Given the lack of competition between banks for mortgage business at the moment amply revealed in my monthly survey of mortgage brokers that does not look like a high probability scenario at this point.

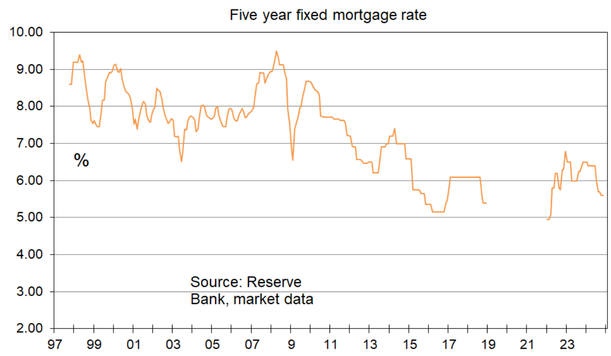
This week the wholesale fixed borrowing costs which banks pay in order to offset fixed mortgage rate lending have edged only marginally lower. At 3.74% the one year wholesale fixed rate is down from 3.81% last week, 3.98% four weeks ago, and 5.24% at the start of the year.



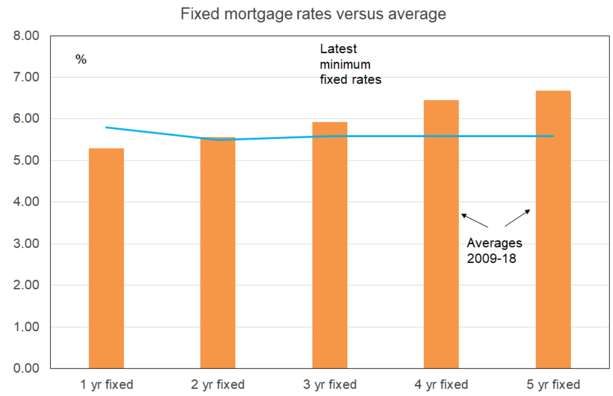
These three graphs show levels of the one, three, and five year fixed mortgage rates over the past few years excluding the 2019-21 period when rates were absurdly low because of worries about deflation and then the effects of the pandemic.







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



I reckon scope exists for the 3-5 year fixed rates to be cut further once banks start more assertively competing for business. For the moment I don't think they are really feeling it. So, I'd still probably fix for a short-term (six months though some feel 12-18 is good), with a view to fixing 3-5 years probably sometime next year. When is anyone's guess in this very uncertain environment.

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.