Economic Note

2024 Household Living Cost Outlook

7 December 2023

Still struggling, but light at the end of the tunnel

- The outlook is uncertain, but we expect the average household having to stump up an extra $70 per week in 2024 just to cover costs following a $115 weekly increase in 2023.
- Overall increases in living costs are slowing, but the impacts are uneven. We expect slowing increases for consumer goods but for still chunky rises in debt servicing and for other consumer services.
- Many households will continue to struggle, and while household spending is under pressure, the solid household income backbone and pent up post-COVID saving has kept the household sector afloat. To get inflation down on a sustained basis will require restraint on the part of households. If not, higher OCR settings may result.

Summary

Households have been acutely feeling the cost of living ‘squeeze’ but signs are brighter, with a $115 weekly increase in costs for 2023 to be followed by a $70 weekly increase in 2024, the lowest since 2020. These figures are for the average household, with some having to pay less, but others more, particularly those with large debt exposures. The inflation outlook remains inherently uncertain, but we expect the pace of cost increases to progressively slow, both in absolute terms and relative to household incomes. Cost movements will be uneven, with slowing increases for consumer goods but for still chunky rises in debt servicing and other consumer services.

Despite warnings of impending doom and subdued consumer sentiment, the household sector has stayed afloat thus far. Solid growth in household incomes and the build-up of household savings post-COVID have increased the buffer available to some households. Others, however, have not been as fortunate and with the labour market deteriorating, pockets of financial stress could grow.

Adding to the challenges facing policymakers is that the battle to lower inflation back to 2% is far from over. We don’t expect further OCR hikes but acknowledge that the RBNZ’s patience is wearing thin. Tangible progress will need to be made in lowering domestic inflation. While households do not set prices, their actions will have a tangible influence. The battle on inflation is not yet won and the RBNZ will be looking for restraint on the part of firms, consumers and government to reduce inflationary pressure. If not, higher OCR settings may result.

Recap

Soaring living costs have been one of the major headaches of the post-COVID period. **This has eroded consumer purchasing power and has made going to the shops a depressing experience for many.** High and variable movements in living costs are economic and social poison, hence the RBNZ’s efforts to stamp out inflation, with 525bps of OCR hikes delivered thus far.

In this note we update our analysis on household living costs. The direction of movement remains up, but encouragingly, the rate of increase is slowing. Annual increases in consumer prices (5.6% in the September 2023 year) and household living costs (7.4% yoy) are off their peaks. The gap between inflation rates of the two largely reflects debt servicing costs, which is a key component of household expenditures that are not included in the current CPI. In a follow-up note we will take a closer look at the impacts of debt servicing costs, teasing out the distributional impacts.

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Household living costs rises slowing

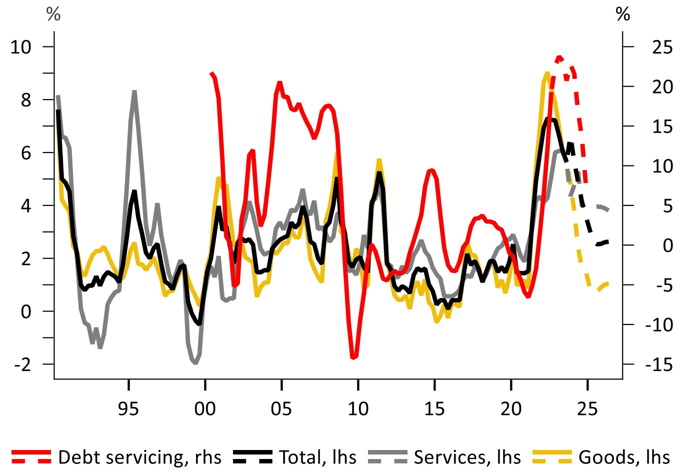
Viewing average weekly living costs by major category (see accompanying charts) has shown a steeper than usual rate of cost increase since COVID-19. **Cost rises were generalised, with few places to hide for beleaguered consumers.**

The rate of increases appears to be slowing, with pressures coming off more quickly for goods than for services. Our expectation is that annual CPI inflation will continue to cool and will settle below 3% in 2025. This largely reflects cooling goods inflation, but stickier services inflation should also cool as inflationary pressures in the labour market subside.

Viewing the sources of cost increases shows some welcome signs. Movements in food prices, transport and miscellaneous goods prices are expected to slow. **However, other areas will not be as benign.** Rises in debt servicing costs are likely to remain chunky, with mortgage rates about two-thirds through their trough to peak moves this cycle. Insurance costs look set to push higher and increases in dwelling rents are likely to be stronger in 2024 given pressures caused by strong population growth. Construction costs could follow, and we expect further sizeable increases in local authority rates given the need to address infrastructure challenges.

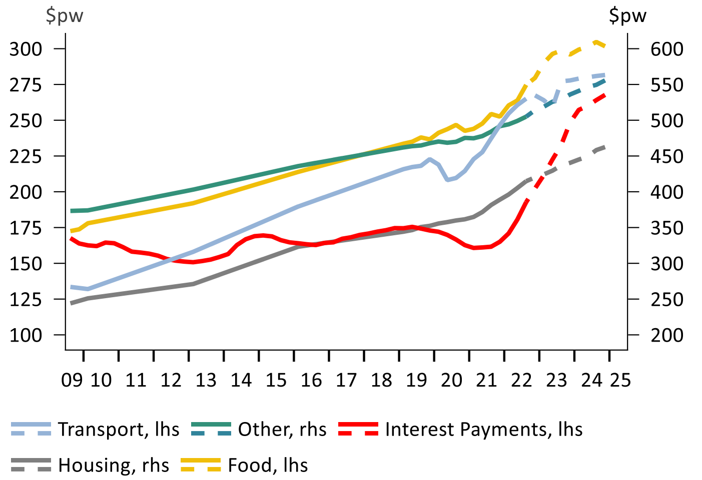
Weekly cost increases for the average household peaked at just under $140 in 2022 and again look set to top the $100 per week mark in 2023 (around $115pw according to our estimates). In both of those years, rising living costs were higher than gains in household incomes (see chart overleaf), reducing household saving buffers. **Households have been acutely feeling the cost of living 'squeeze'. The outlook is uncertain, but signs for 2024 are brighter, with our estimates suggesting the average weekly cost increase for households will ease to $70 per week**. This is expected to be below the weekly rise in household disposable incomes. **Cost increases for 2024 are likely to be the lowest annual increase since 2020, but they are still elevated relative to pre-COVID times where the low inflation environment kept overall cost increases in check.** We caution that these are average figures, with fortunes differing by household. Rising living costs will be a struggle for many households.

NZ Goods & Services Prices and Debt servicing



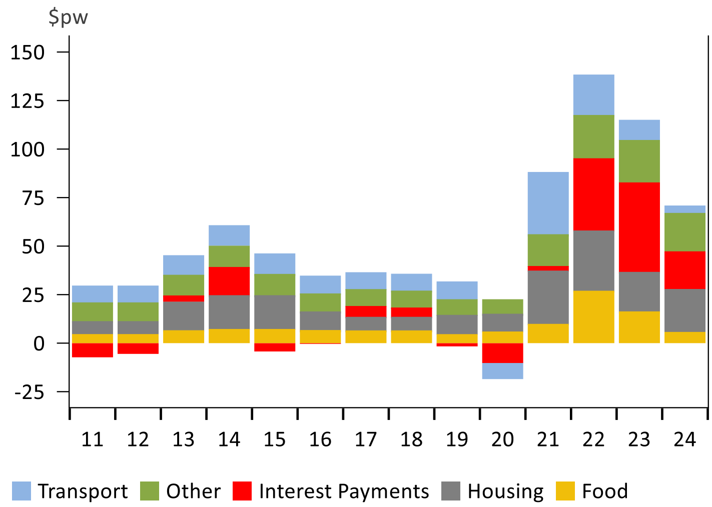
Source: Macrobond, ASB

NZ Weekly Household Living Costs



Source: Macrobond, ASB

Weekly Change in Household Living Costs



Source: Macrobond, ASB

Household sector has stayed afloat

Higher living costs are a significant headwind, but to date the household sector has coped reasonably well overall. In part this is a consequence of the COVID-19 period when overall household incomes benefitted from government support. Record low household borrowing costs and the resilient economic backdrop have also played a role, with household disposable income growth at solid rates. Kiwi households are not dissaving in aggregate. Kiwi households have built up a circa $30bn nest egg of savings since the COVID-19 pandemic. The amount of saving is being eroded as growth in household expenditures has outpaced income growth. Still, households in aggregate are still saving.

The concern is that the households who have built up the savings will not be the ones who need to find additional funds to cover higher living costs. It will mean considerably reduced funds available for households after paying down the mortgage, with discretionary spending likely to be pressured lower. **The Christmas mood is expected to remain sombre for many this year and we envisage 2024 will still be difficult for many households.**

The hit to the household sector is being masked by strong NZ population growth with net immigration to NZ around record highs. Our research on the impacts of net immigration suggests that the current composition of migrants is not adding as much grunt to domestic spending that historically has been the case. However, it also suggests high net immigration could still add significantly to medium-term inflationary pressures, consistent with the tougher line the RBNZ took in the November MPS.

The inflation outlook is inherently uncertain, but our view is that conditions are in place that should see pressures on domestic inflation cool. The tight labour market has cooled appreciably over the past 12 months and looks to cool further still. This is a key pre-requisite to driving core inflation lower on a sustained basis, but it is not the only thing on the RBNZ's wish list. Nonetheless, domestic spending will need to slow to get core inflation down. The spotlight at the moment is on fiscal policy, with the RBNZ message that a tighter fiscal stance is required to cap OCR settings. However, **the household sector is a much bigger portion of the economy, and while households do not set prices, their actions will have a significant impact on the inflation process.**

Implications

What are the monetary policy implications? Lowering inflation is priority 1,2 and 3 on the RBNZ's must-do list. Despite 525bps of OCR hikes thus far domestically generated inflation has barely budged, with overall inflation still above the 1-3% target for 2½ years and counting. The longer inflation remains above 3%, the harder it will be for the RBNZ to deliver circa 2% inflation on a sustained basis. The last part of the journey below 3% inflation could be particularly testing. Hence the tough talk by the RBNZ and the warning that the OCR may have to go up if inflation fails to sufficiently cool.

Lowering inflation needs to be a team effort. Firms, policymakers and households will need to play their part. Ongoing consumer restraint and increased consumer resistance to paying higher prices are key pre-requisites to cooling domestically generated inflation. If households decide to pop the champagne corks too soon, they might discover a nasty interest rate induced hangover will result.

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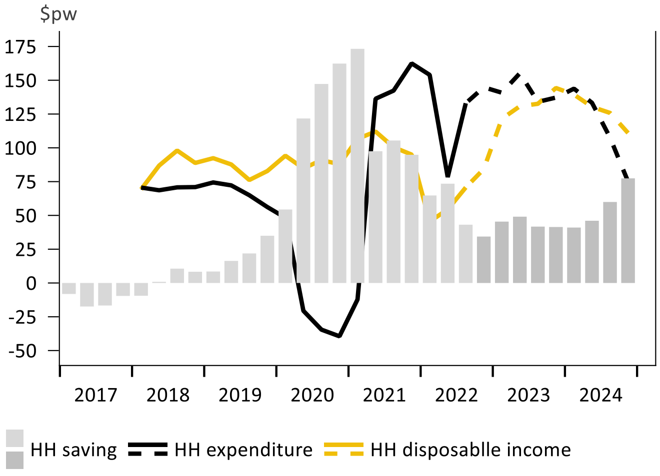
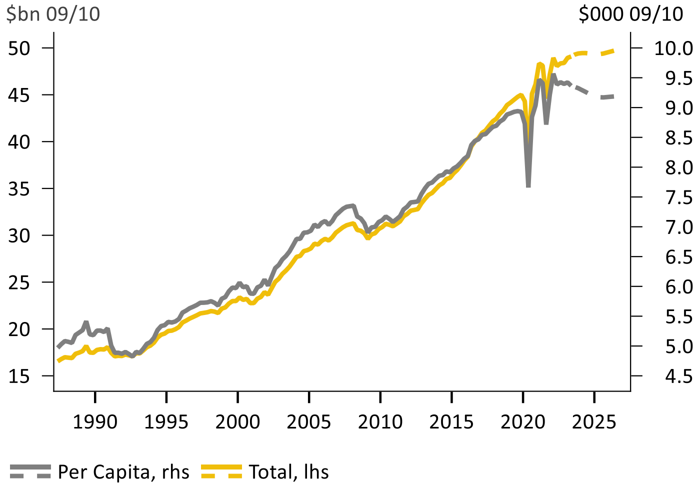
Annual weekly changes in Household Incomes and Spending



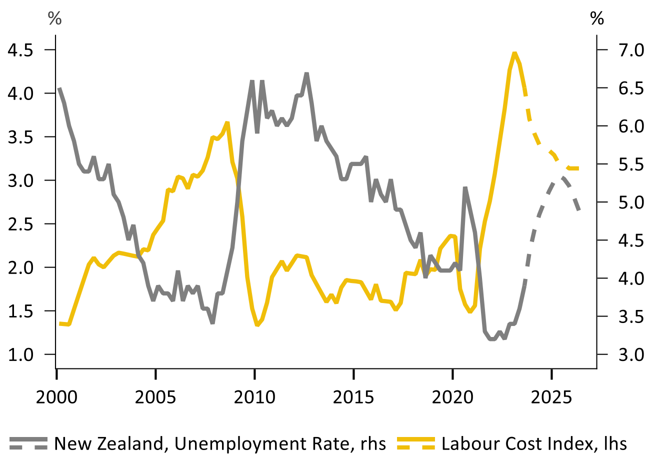
Source: Macrobond, ASB

Household Spending Volumes



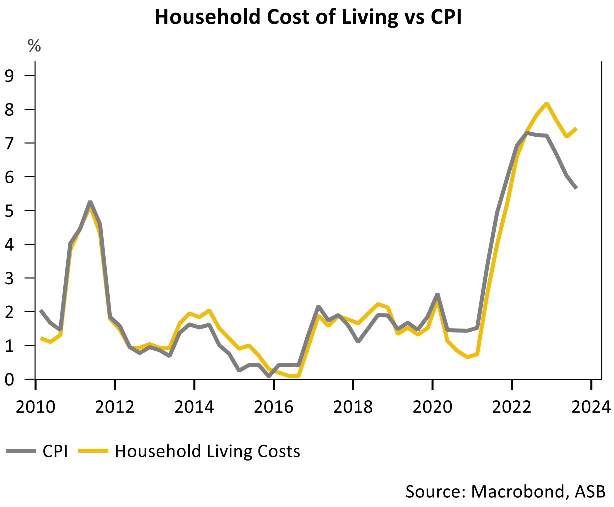
Source: Macrobond, ASB

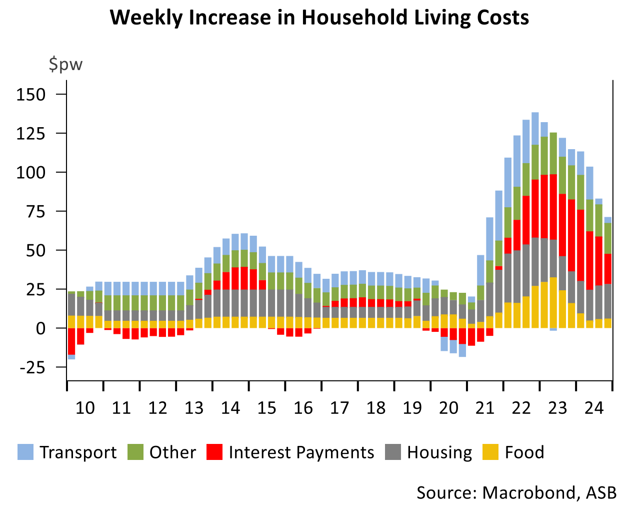
Labour Cost Growth & Unemployment Rate

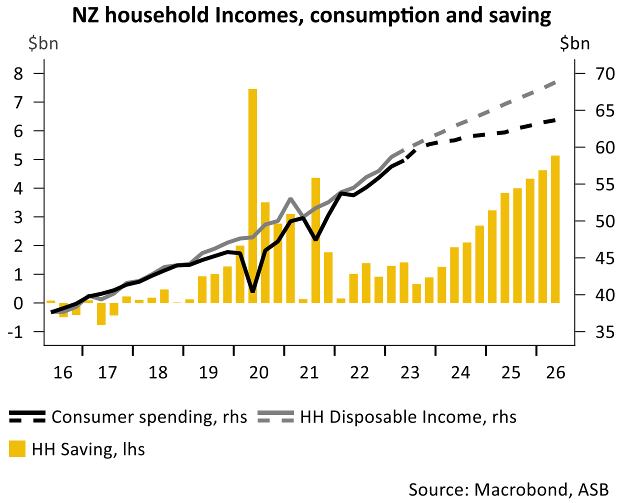


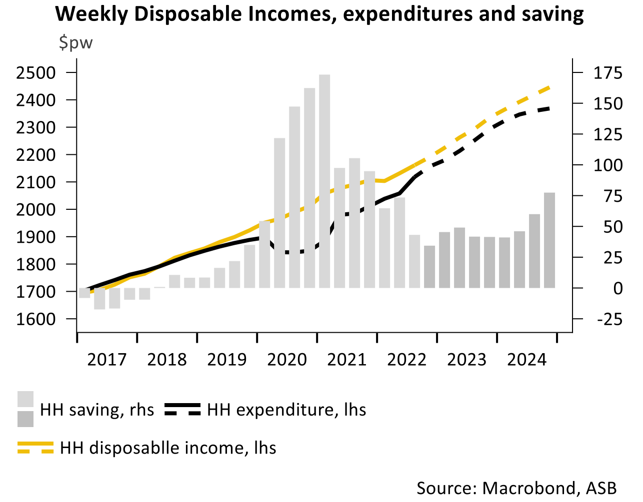
Source: Macrobond, ASB

Graphical appendix









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