

REFERRER NEWS

with Tony Alexander

Monetary policy outlook better for 2024

Central banks sometimes like to surprise the financial markets in order to keep people on their toes. But that is not what has just happened here in New Zealand. This week the Reserve Bank conducted their regular review of the official cash rate and met universal expectations of no change. The rate still sits at the 5.5% level it was taken to at the end of May this year.



The next review of the cash rate doesn't happen until the end of February and by the time we get there we will have in hand a lot more data on the New Zealand economy and a lot more information regarding the speed with which inflation is falling. At the moment the inflation rate is 5.6% which is down from the peak last year of 7.3%. That is good.

But at 5.6% inflation is much too far away from the 1% to 3% target band to allow the taking of any risks by the Reserve Bank. In particular, they are not going to take the risk of easing monetary policy without solid evidence that the loosening of New Zealand's labour market is leading to a solid reduction in the pace of wages growth.

We can tell from various indicators that the record net migration inflow into New Zealand over the past year of 119,000 people has greatly changed the dynamic in the labour market in favour of employers in many sectors. Economic theory and history tell us that with more employees available the pace of wages growth will slow down.

But as yet we have zero data in hand proving that this is happening. In fact what we do have are many businesses who require skilled people still saying that finding staff represents a problem. We also have a great number of young Kiwis leaving the country for a variety of reasons and a key factor will be the low level of wages compared with Australia in particular.

Growing awareness of the wage disparity of New Zealand with Australia could keep our pace of wages growth relatively strong in the near future. Or maybe not. We simply don't know, and this is one of the many uncertain factors the Reserve Bank has to take into account when it considers the speed with which inflation will go down from here.

In three months time we will also have a lot more information with regard to the strength of recovery in the tourism sector. This is a very important export for New Zealand and the most recent data showed that visitor numbers were running at about 86% of their level ahead of the global pandemic. The Chinese market has yet to kick in and when it does this will be very positive for our economy.

But for the moment China's economy looks relatively weak with consumers over there pulling back on spending in order to rebuild savings in the face of rising unemployment and wealth lost in the retrenching property sector.

Come the end of February we'll also have a better idea of how bad the El Nino weather pattern will be and whether or not deep drought conditions will have set into the east coasts of the North and South Islands. Already we can see evidence that farmers have closed their wallets from about four months ago and regional economic weakness matters a lot for the New Zealand economy.

There is also economic weakness coming from falling house construction in New Zealand. The strong increase in property listings from early 2022 has encouraged buyers to focus on properties already built rather than putting in orders for new houses to be constructed. This situation will probably change quite strongly from early in 2025, but before we get there falling house construction will act as a drag on the economy.

There will be some slight offset from rising house prices. House prices on average in New Zealand bottomed out in May and since then have increased by 4%. My monthly surveys of residential real estate agents and mortgage brokers show good but not rapidly rising numbers of both first home buyers and investors coming into the market. I cannot see any evidence of a frenzy in the real estate market and in particular see no evidence that investors are once again jumping boots and all into the market just because interest expense deductibility will be restored earlier than previously expected.

Nonetheless, when we offset falling construction against rising demand from the record net migration inflows pushing young buyers out of renting and into buying it seems highly reasonable to expect that house prices will continue to rise through 2024.

Rising house prices can generate a positive spending impact on the economy, though I doubt that the effect will amount to much over 2024 given that prices are still well down from where they were at the end of 2021.

The key determinant of strength in the housing market is going to be the speed with which interest rates decline, and the speed with which interest rates decline will be partly influenced by the degree of strength in the housing market and the impact which it has on wider decisions of consumers whether to spend or not.

Taking all these considerations and many others not mentioned here into account the Reserve Bank is not going to be taking any risks with monetary policy for quite some time. But if we're lucky, come the next official cash rate review late in February we will have data in hand showing slowing wages growth and a further decline in the inflation rate. That means at that time the Reserve Bank may just make a positive comment about scope for monetary policy easing in the second half of 2024.

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