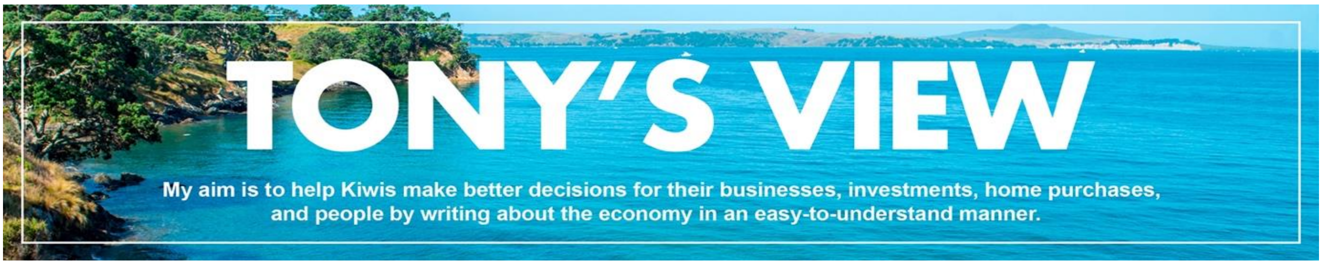

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A muted growth outlook

There have been no data releases of any great significance in New Zealand this week, and even if there were I'd be downplaying their relevance because they wouldn't reflect the post-Iran invasion environment.

So, let's again have a look at the broad macroeconomic outlook after trying to add an overlay for the effects of the Middle East war. This is the approach I am in the midst of taking for a number of talks in Auckland this week to a range of different client bases.

Basically, before February 28's attacks the outlook for our economy was one of growth this year but nothing spectacular. In fact, a few measures were already telling us that the good momentum seen entering the second half of 2025 was easing off in some areas.

For instance, in rough seasonally adjusted terms the number of dwellings sold around the country fell 4% in the three months to February after rising 7% in the three months to November.

Growth in core retail spending measured using debit and credit cards slowed again in seasonally adjusted terms from 0.8% to 0.6% for the same quarterly periods. Growth for the three months to August last year had been 1%.

Business confidence about the year ahead measured in the ANZ's Business Outlook survey had already fallen from a peak of 74% early in December to 59% early in February. Employment intentions eased from a net 28% positive to 22%, and residential construction expectations from a net 55% to 41%.

None of these measures were telling us that having a positive outlook for the economy over 2026 would be unwise. But they were reinforcing to us all that the year would not be a boomer. Now, that is definitely the case.

We have to allow for hikes in oil prices causing growth this year to be slower than would otherwise be the case. Inflation and business cost increases will be higher than expected and interest rates also more elevated in the wholesale markets.

Profit margins for many businesses will be smaller than anticipated meaning share prices lower and business closure numbers higher.

CBD recoveries will be set back for a few months as more people work from home and this may be the last straw for some hospitality businesses which have held on this far.

Inward visitor numbers will be lower than anticipated but there may not necessarily be greater domestic tourism because of the fuel costs. We might instead allocate some extra funding once again to home renovations. But the extent of any gain may be wiped out by higher costs stemming from supply chain disruptions, higher transport costs hitting all materials, and higher plastics prices in particular.

But it is still reasonable to expect some overall improvement in economic activity levels in New Zealand this year because of various factors.

Farm incomes have risen strongly, especially for dairy and beef, and Fonterra have a capital payout coming for the former group of $3.2bn. Some will be used to repay debt, some to upgrade farm facilities, some for off-farm investments, and some will be used to buy nice things.

Interest rates may be rising at the moment but average levels are still below where things were in late-2024 and that will be of assistance to borrowers.

Infrastructure spending is rising with decades of maintenance spending to catch-up on and improvements to be made to allow proper functioning of a modern economy.

Foreign student numbers are rising strongly and that is especially good for inner city Auckland and Christchurch.

Net annual migration flows have improved from 11,000 in the middle of last year to about 23,000 now. That means slightly stronger population growth and maybe the turbulence offshore will cause a few Kiwis to return and a few to delay their offshore adventure for a while.

The number of consents issued for new dwellings to be built bottomed out at 33,500 in the middle of last year and now stands at 37,000. Some of these consents may not be acted on in the short-term because of predictions of soaring costs. But the is strength evident from those looking through the temporary situation in the Middle East.

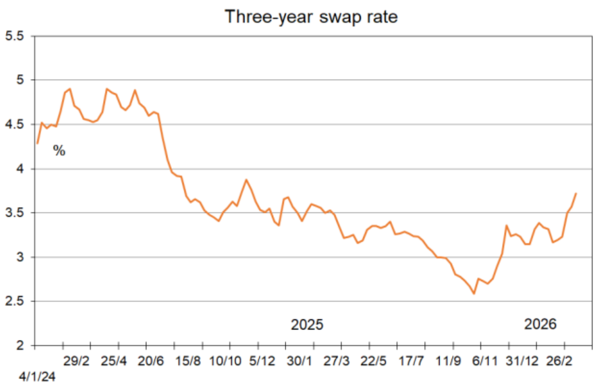
Finally, we have entered this crisis with the various measure of sentiment and spending intentions above average and in far better shape than was the case going into the pandemic and the start of Russia's invasion of Ukraine.

Overall, I think one can feel justified in expecting and planning to take advantage of a stronger economy as we advance through 2026.

And finally, I know someone is going to write something like this so let's see if I'm the first. You survived to '25, hoped for your fix in '26, but maybe you'll get your heaven come '27.

If I were a borrower, what would I do?

Wholesale interest rates have climbed this past week primarily in response to the poor developments in the Middle East bringing deepening global worries about inflation. US bond yields have gone up and our three year swap rate for a while climbed to near 3.85% from 3.57% last week and 3.2% just before President Trump launched the war. It now sits near 3.72% reflecting hopes of peace negotiations being underway – maybe.



There was also some upward pressure on NZ interest rates from Fitch credit rating agency downgrading their outlook for our government debt from stable to negative. The long-term fiscal outlook for New Zealand is poor following the near doubling of debt undertaken during the pandemic and our established history of facing a debt-promoting crisis every ten years or so according to Treasury.

There was mild downward pressure from the Reserve Bank Governor's speech on Tuesday which caused markets to slightly pare back their expectations for the extent of monetary policy tightening this year.

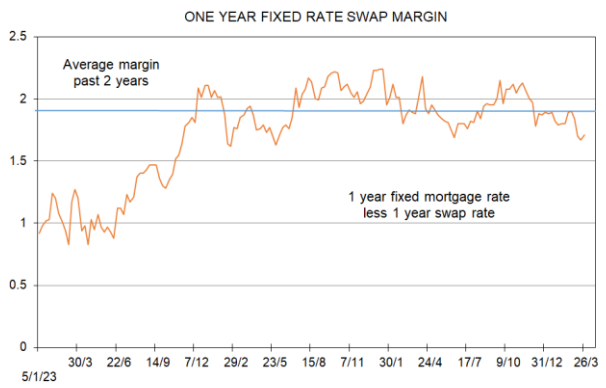
My view is that the bias of our central bank towards tightening too late rather than too early means a rise in the official cash rate is not guaranteed this year. But after that rapid rate rises are likely as they catch-up on tightening.

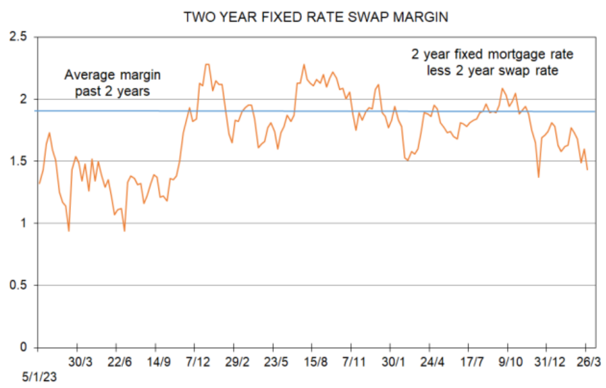
I remain concerned about underlying inflationary pressures even though our growth outlook has deteriorated because of the new Middle East war.

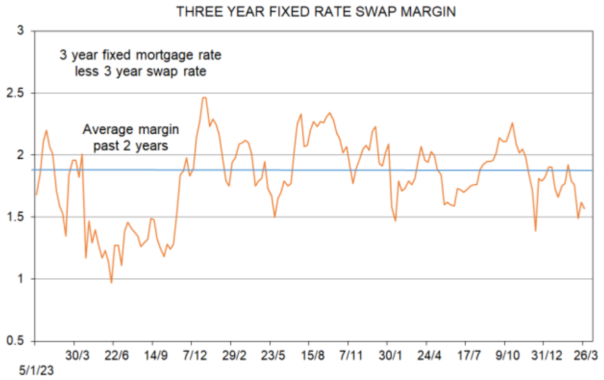
The time for anyone to lock in cyclically low fixed borrowing costs has well and truly passed and the five year swap rate which banks must pay to borrow fixed five years for on-lending to you and I sits currently near 4.0% from the cyclical low of 2.9% in October last year.

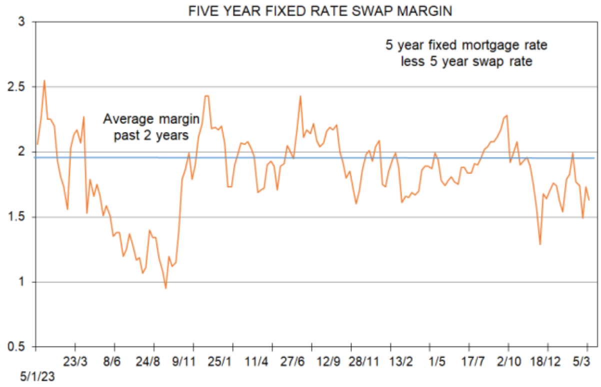
Nonetheless, if I were borrowing at the moment I would personally favour fixing for three years.

Note that as a result of wholesale rate rises this week bank fixed rate lending margins are well below average. Scope exists for increases near 0.3% across the board.









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.