ECONOMIC BULLETIN

Update on household finances.

29 Jan 2025 | **Satish Ranchhod**, Senior Economist | +64 9 336 5668 | +64 21 710 852 | satish.ranchhod@westpac.co.nz

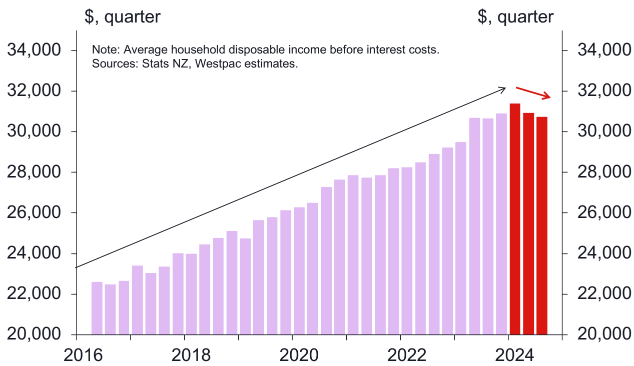
The squeeze is set to ease! 2025 to see reduced pressure on household finances.

- **With a slowdown in economic growth and rising unemployment, household income growth stalled over the past year.**
- **However, there is better news on the horizon for New Zealand households in 2025. Inflation has dropped and it's set to remain close to 2% over the year ahead.**
- **Importantly, lower inflation has allowed the RBNZ to cut the Official Cash Rate, and there have been related falls in mortgage rates. Over the next six months, close to half of all fixed-rate mortgages will come up for repricing, which will see sizeable reductions in households mortgage costs.**
- **While borrowing costs are dropping, they look set to return to average levels, rather than the very low ones that we saw in the wake of the pandemic. As a result, the recovery in economic activity and the housing market is likely to be gradual and a return to trend rates of growth (rather than very elevated levels).**

The past year saw income growth stall, while living cost continued to push higher.

The latter part of 2024 saw a continued squeeze on household finances. Stats NZ's recent update has shown that there was no growth in New Zealand households' before-tax incomes between the March and September quarters. Over that same period, we saw unemployment rise to 4.8% and the level of economic activity shrank by around 2%. Against that backdrop, it's no surprise that wage and salary growth stalled, as did the returns to business owners.

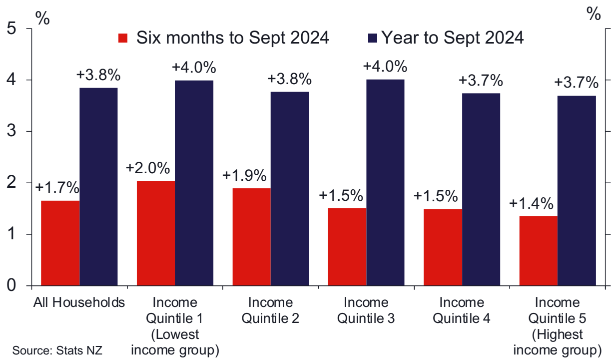
Disposable income growth has stalled



While incomes have flatlined, living costs continued to climb, rising by 1.7% in the six months to September alone. Many lower income families have faced even larger increases in their living costs, with rents a notable area of pressure. That's meant many households have seen their purchasing power going backwards.

The pressure on incomes is likely to continue for some time yet. Recent business surveys have highlighted continued softness in economic activity, including weakness in hiring. Those conditions are likely to see unemployment rising to over 5% in 2025, with wage growth also set to continue easing.

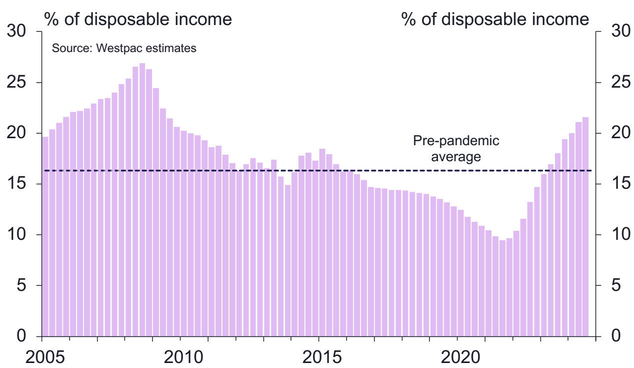
Household living costs



Increases in housing costs, including mortgage interest, have taken a big bite out of disposable incomes.

A particular strain on households' purchasing power has been increases in housing costs. In addition to continued increases in rents (which rose 4.2% over the past year), household spending on debt servicing has continued to climb. About one-third of households live in their own house and have a mortgage. We estimate that for those households, their spending on interest costs has now risen to around 20% of their disposable incomes. In comparison, prior to the pandemic, households with mortgages were spending around 16% of their incomes on interest costs. And in recent years, that ratio got as low as 10%.

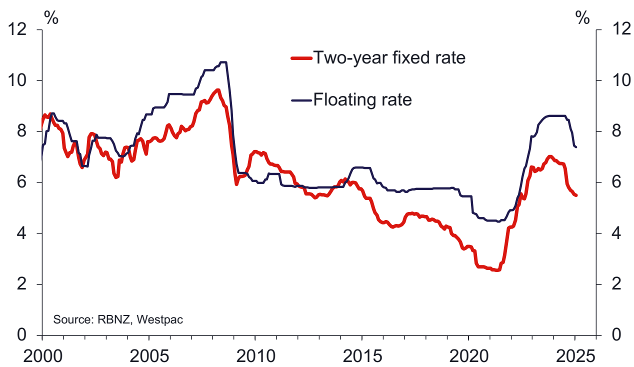
Spending on interest costs (households with mortgages)



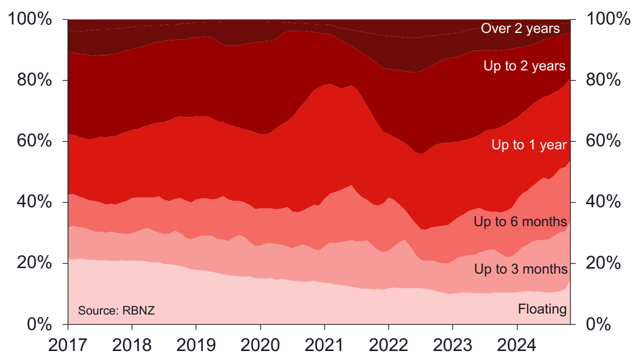
The increase in debt servicing costs has been despite the fall in mortgage interest rates over the past year. That's because many borrowers fixed their mortgages for a period at very low rates in the wake of the pandemic, and they have now rolled on to the higher rates currently on offer.

We've also seen many borrowers opting for shorter fixed terms or going on to floating rates for a time in anticipation of further interest rate reductions from the RBNZ. However, floating and shorter-term mortgage rates are currently higher than those that are fixed for longer periods. As a result, even though carded interest rates have been dropping, the average rate that borrowers are paying hasn't yet fallen significantly.

Mortgage rates



Share of mortgages by time to refixing



With slowing income growth and further increases in debt servicing costs, it's no surprise that per capita household spending fell around 1% over the past year. And while it's started to push higher again, it's still looking soggy.

Of course, not all households have mortgages. Many own their own home outright, and large numbers of us rent. However, as we discuss below, even these households could be affected by the recent moves in interest rates. Notably for savers, higher interest rates could actually be desirable.

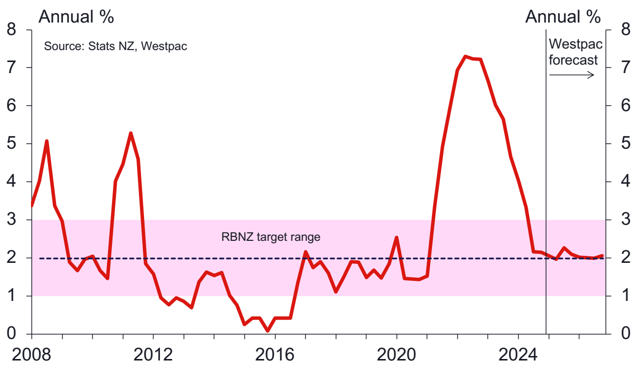
The squeeze is set to ease!

The good news for many households is that the coming year is likely to see some relief for their finances.

On the cost-of-living front, the inflation outlook for the coming year is looking much less scary. We expect that inflation will track close to 2% over the year ahead – a far cry from the rates of over 7% we saw in recent years.

But even though inflation has stabilised, for many of us it doesn't feel like the cost-of-living crisis has ended. And that's because it hasn't. High inflation in recent years has eaten away at every household's spending power and it will take time for that lost ground to be recovered. However, lower inflation means that far fewer households will see their finances going backwards over the coming year, and it also puts the economy on more a sustainable growth path. That will be crucial for supporting a recovery in the labour market and household incomes.

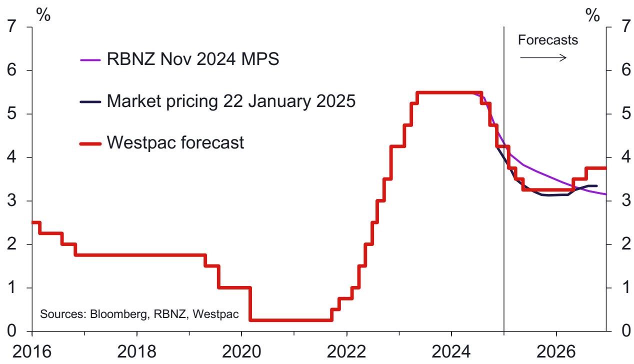
Consumer price inflation



Importantly, with inflation now looking contained, the Reserve Bank has begun cutting the Official Cash Rate (OCR). Since August 2024, the OCR has fallen 125bps to a level of 4.25%. We expect that the RBNZ will deliver another 50bp cut in February, followed by additional 25bp cuts at both the April and May policy meetings. That would take the OCR to 3.25%, its lowest level since 2015.

The fall in the OCR has seen carded mortgage rates dropping rapidly in recent months. And for borrowers, this means that they are nearing the end of the re-fixing cycle when they were rolling on to higher rates.

RBNZ to deliver another 50bp OCR cut in February



Over the next six months, close to half of all fixed-rate mortgages will come up for repricing. For those borrowers who fixed up to two years ago, they could see their interest rate dropping by more than 100bp when they next refix their rate (depending on when they took out their mortgage and how long they fixed for). However, if you had fixed for three or more years, you'll actually be rolling on to a higher rate, though you'll still avoid the very high interest rates that we saw last year.

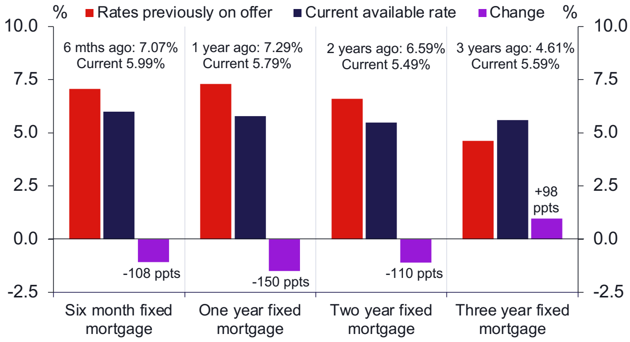
As shown in the table below, those lower interest costs could have a dramatic impact on households' disposable incomes. For instance, suppose you have an average-priced house with 50% remaining on your mortgage. If you had fixed for one-year at the start of 2024 and then refix for one year again now, your minimum monthly payments in most parts of the country would fall by around $300 per month. If you live in Auckland where house prices tend to be higher, that fall in debt servicing costs would be over $400 per month.

Mortgage repayments

Region	House prices		Monthly mortgage costs (20 year term)		
	Median house price (Dec 2023)	50% mortgage	One-year fixed rate one year ago: 7.29%	One-year fixed rate as at 22 Jan 2025: 5.79%	Change
Northland	$630,000	$315,000	$2,498	$2,219	-$279
Auckland	$1,045,000	$522,500	$4,143	$3,681	-$462
Waikato	$765,000	$382,500	$3,033	$2,695	-$338
Bay of Plenty	$830,000	$415,000	$3,291	$2,924	-$367
Gisborne	$555,000	$277,500	$2,201	$1,955	-$246
Hawke's Bay	$661,000	$330,500	$2,621	$2,328	-$293
Taranaki	$640,000	$320,000	$2,537	$2,254	-$283
Manawatu/Whanganui	$524,500	$262,250	$2,080	$1,848	-$232
Wellington	$809,000	$404,500	$3,207	$2,850	-$357
Nelson/Marl/Tas	$720,000	$360,000	$2,855	$2,536	-$319
Canterbury	$665,000	$332,500	$2,637	$2,343	-$294
Otago	$675,000	$337,500	$2,676	$2,378	-$298
Southland	$445,000	$222,500	$1,764	$1,568	-$196
Nationwide	**$779,830**	**$389,915**	**$3,092**	**$2,747**	**-$345**
NZ excl. Auckland	$700,000	$350,000	$2,775	$2,466	-$309

Notes and sources: We looked at the mortgage payments for homes based on the REINZ's data on median house prices from December 2023. We assumed a mortgage for a term of 20 years. The mortgage rates used were based on data from the RBNZ and interest rates currently on offer. For simplicity, we've assumed that the amount of borrowing is the same in 2024 and now.

How much relief could borrowers see?

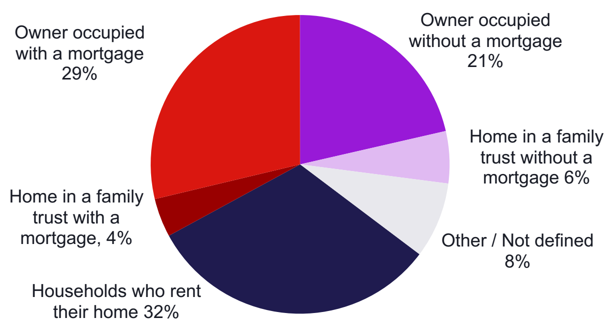


Source: RBNZ data for borrowers with over 20% equity. Current rates on offer from Westpac as at 22 Jan 2025.

Same-same, but different.

Only around one-third of New Zealand households live in their own home and also have a mortgage. Around one third of us rent. And the remainder are mortgage free. However, even households without mortgages are likely to be affected by the easing in financial conditions now in train.

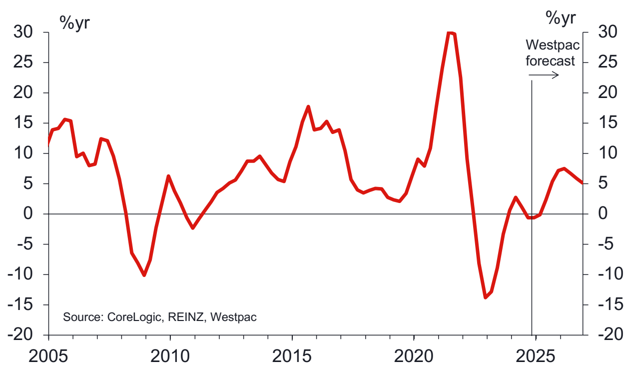
Household groups with and without mortgages



Source: Census 2023 / Stats NZ, Westpac

For those who own their home outright or have a mortgage free investment property, the falls in interest rates we're now seeing will likely lift the value of their assets over the coming year. We're forecasting that house prices will rise by around 8% this year and 5% in 2026. Those gains are likely to boost confidence and spending appetites. However, for savers, lower interest rates could affect their returns.

House prices



Source: CoreLogic, REINZ, Westpac

Those households who rent are not directly exposed to falls in interest rates. However, there's a good chance that their house or flat still has a mortgage associated with it. And increases in interest costs were an important contributor to the rise in rents over the past few years.

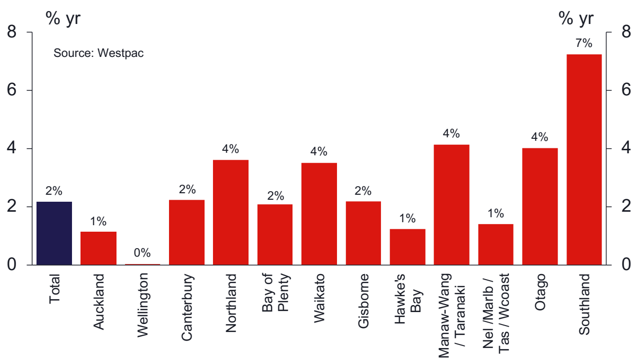
As we've entered 2025, rents are continuing to rise, with landlords reporting ongoing increases in operating costs, like insurance and rates. However, we're starting to see some of the pressure on rents ease. That's in part due to the fall in mortgage servicing costs, as well as factors like slowing population growth.

The loosening in financing conditions is also important for those who currently rent, as the related improvement in debt serviceability could also make it easier for them to purchase a home.

Rising commodity prices will also help to boost household earnings in rural regions.

Another factor that will help to support earnings and alleviate the pressure on households' finances is the lift in New Zealand's export commodity prices. Export prices had already been pushing higher over the past year, and the outlook for 2025 is looking positive. In particular, we're forecasting a farmgate milk price of $10.00/kgMS this season. Combined with a lower New Zealand dollar, that will boost export earnings, which will help to support household incomes and spending. Consistent with that, we're already seeing retail spending firming in regions with a strong agricultural backbone like Southland, Otago, Northland and Waikato.

New Zealand spending growth by region (December vs same time last year)



Re-balancing.

It's important to remember that while borrowing costs are dropping, they look set to return to average levels, rather than the very low ones that we saw in the wake of the pandemic. And while those reductions will help to support both economic growth and house prices, we expect the recovery to be gradual and will lead to a return to trend rates of growth (rather than very elevated levels).

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